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No. _____

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,
Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellee.

On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the Constitution, may apply a unitary business formula to a corporation and thereafter tax, as the corporation's income from its business activities conducted within the taxing State, income derived from other operations of the corporation where:

(a) The business activities of the corporation outside the taxing State are involved in the maufacture, sale and distribution of paper boxes and related products, none of which occur in the taxing State, and the business activities of the corporation in the taxing State are limited to the operation of two cattle ranches which do not functionally contribute to or functionally assist the other activities of the corporation; and

(b) The sole connection between the business activities of the corporation in and out of the taxing State consist of the provision of some central management services to the cattle ranches by the home office of the corporation, located outside the taxing State, and the transfer of funds between the operations of the corporation in the taxing State and the general account of the corporation; and

2. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the constitution, may apply a unitary business formula to a corporation conducting business both within and outside the taxing State, where use of the formula results in the apportionment to the taxing State of 19% to 30% of the corporation's total net income, when

(a) The business operations of the corporation within the taxing State sustained losses in all the years involved; and

(b) The percentage of net income apportioned to the taxing State is four to five times the percentage of gross sales derived from the corporation's operations within the taxing State.[1]

[1] The Appellant has no parent companies, subsidiaries or affiliates. The taxpayer in the state courts was Ward Paper Box Company which has been merged into Russell Stover Candies, Inc. Ward Paper Box Company was not a subsidiary of Russell Stover Candies, Inc. during the tax years in question.

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On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of the State of Montana, following remand of this matter to it from this Court, is reported in 665 P.2d 198 (Mont. 1983). The earlier opinion of the Supreme Court of Montana is reported as *Ward Paper Box Company v. Department of Revenue of the State of Montana*, 638 P.2d 1053 (Mont. 1981). Included in the Appendix to the Jurisdictional Statement are copies of the Opinion of the Montana Supreme Court following remand (App. A, pp. 1-10); the Order of this Court vacating the judgment and remanding this matter to the Supreme Court of the State of Montana for reconsideration (App. A, p. 11); the initial Opinion of the Supreme Court of the State of Montana (App. A,

pp. 12-20); the unreported Opinion and Order of the District Court of the First Judicial District of the State of Montana, in and for the County of Lewis and Clark (the "District Court") (App. A, pp. 23-30); the unreported Findings of Fact, Conclusions of Law and Order of the State Tax Appeal Board of the State of Montana (App. A, pp. 31-41); and the unreported decision of the Hearing Officer of the Department of Revenue of the State of Montana (App. A, pp. 42-49).

JURISDICTION

This proceeding involves the application of Montana's corporate license tax statutes. For the purpose of computing the income tax due the State of Montana, the Montana Department of Revenue applied a "unitary business formula" to the operations of Ward Paper Box Company located within and outside the State of Montana. Appellant challenged this action on both statutory and constitutional grounds.

Appellant's arguments were rejected by the State Tax Appeal Board of the State of Montana and Appellant filed a Petition for Judicial Review with the District Court. Appellant's statutory arguments were upheld by the District Court. In its December 1981 decision, the Montana Supreme Court reversed and held that the unitary formula was properly applied to the operation of Appellant for the taxable years 1971 through 1975. As a result, income from operations occurring completely outside of Montana was included within the net income of the corporation for the purposes of computing the corporate license tax imposed upon Ward Paper Box Company for those tax years.

The Montana Supreme Court rendered its initial decision on December 21, 1981. The Appellant filed Notices of Appeal with the Montana Supreme Court and the District Court. Thereafter, the Appellant filed its Jurisdictional

Statement with this Court. The Department of Revenue filed a Motion to Dismiss Appeal, and the Appellant responded with a Brief in Opposition to the Motion to Dismiss Appeal. Thereafter, the Department of Revenue filed a Supplemental Brief. By Order of this Court dated October 4, 1982, reported at 74 L. Ed. 2d 41, this matter was remanded to the Supreme Court of the State of Montana for reconsideration in light of *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 787 (1982) and *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 819 (1982).

Upon receipt of this Court's order, the Montana Supreme Court established a briefing schedule. The parties submitted briefs to the Court and oral argument was held on March 9, 1983. The Supreme Court of Montana rendered its decision following remand on May 19, 1983. The Appellant filed a petition for rehearing which was denied by the Montana Supreme Court by Order dated July 7, 1983. The Appellant filed Notices of Appeal with the Montana Supreme Court and the District Court on August 19, 1983.

This appeal is taken pursuant to the provisions of 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Due Process Clause of the Fourteenth Amendment to the Constitution:

> No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property without due process of law. . . .

Section 15-31-301, Montana Code Annotated (MCA), states:

Corporations subject to allocation and apportionment. (1) Any corporation having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this part.

(2) A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.

(3) A corporation not engaged in a unitary business must allocate its business income by means of separate accounting methods, provided its books and records are so kept that the income and expenses attributable to business operations within the state can be properly segregated from total income and expense. If the corporation's books and records do not permit such proper segregation, its business income must be apportioned according to the provisions of 15-31-305.

STATEMENT OF THE CASE

Appellant, Russell Stover Candies, Inc., is the successor to all interests of Ward Paper Box Company, the taxpayer in the proceedings below. Ward Paper Box Company, a Missouri corporation, was merged into Russell Stover Candies, Inc., a Missouri corporation, which is the surviving corporation, by documents filed December 21, 1981. By order of the District Court dated March 19, 1982, Russell Stover Candies, Inc. was substituted for Ward Paper Box Company in this action. (App. D, pp. 60-61.)

Ward Paper Box Company was, in tax years 1971 through 1975, engaged in the business of manufacturing,

distributing and selling paper boxes and related products. It was a Missouri corporation qualified to do business in Montana. It maintained its principal place of business in Kansas City, Missouri. All of its common stock was owned by Mr. Louis Ward. (App. A, pp. 3, 13, 24.)

During the years in question, the activities of Ward Paper Box Company consisted of seven divisions. The divisions located outside of Montana were involved in the manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consisted of two cattle ranch divisions; one in Meagher County and one in Powell County, Montana. (App. A, p. 31.) The paper box divisions did not manufacture, distribute or sell paper boxes or paper box products in Montana. These divisions did not engage in agricultural or livestock activities in Montana. The ranch divisions operated solely in Montana, producing livestock, hay, forage and other crops. (App. A, pp. 3, 13, 32.) The Montana State Tax Appeal Board recognized that the corporation was engaged in two business activities. (App. A., p. 38.)

At the Montana ranch divisions, the resident ranch manager made day-to-day managerial decisions. However, major decisions concerning the ranch divisions such as purchase of equipment and the purchase and sale of cattle required the approval of Mr. Louis Ward or the President of the Company. In addition, the Kansas City home office of the corporation prepared all federal and state reports, hired accountants to prepare tax returns, kept all books, prepared financial statements and balanced all checkbooks. Each ranching division was charged $60.00 per month for all home office services. On the other hand, there were no joint advertising programs, no common salesmen or common guarantees among the

divisions. Personnel of the box divisions did not transfer to the ranch divisions. The divisions did not exchange equipment and did not purchase products jointly.

Each division, including the Montana divisions, had an expense bank account maintained in Kansas City. Any monies generated by the division were deposited in the division's expense account. If the division did not immediately need the funds, those funds would be transferred from the separate division expense account to a general account of Ward Paper Box Company. Such funds would thereafter be utilzied when needed in any of the separate division operations. The President of Ward Paper Box Company would make the decision as to such transfers. When either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from the general account to the ranch divisions' expense accounts.

Each ranch division maintained a payroll account in a Montana bank. Checks on those accounts could be written by the ranch manager. However, records were maintained in the Company's home office which also balanced the books and made deposits to the payroll account. (App. A, pp. 3-5, 13-15, 25.)

For the years 1971 through 1975, Ward Paper Box prepared and filed its Montana tax returns using a separate accounting method for the Montana ranch divisions. In each year, it paid the minimum corporation license tax of $50.00. During those years, the operating costs and depreciation expenses of the Montana divisions exceeded the income generated by those divisions. During the same time period, Ward Paper Box filed tax returns under the unitary apportionment method in the other states in which it operated. The Montana ranch divisions

were included as a part of its total unitary business in those returns. (App. A, pp. 3, 13-14.)

Appellee, Department of Revenue, determined that the Montana activities of Ward Paper Box Company were part of a unitary business. Thereafter the Department applied a unitary business formula in which the total income of the corporation, including the income generated by other divisions, was apportioned to Montana by use of a three-factor formula. The formula contrasted the property, payroll and sales of the Montana operations to the total property, payroll and sales of the corporation. The result was divided by three and yielded a percentage. This figure was applied to the total net income of the corporation to determine the income apportioned to the State of Montana.

The following table shows the computation made by the Appellee for the tax years involved:

	1975	1974	1973	1972	1971
SALES FACTOR					
From Sch 8 & 9					
Montana	$ 667,267	$ 673,011	$ 547,902	$ 110,732	$ 356,581
Total	9,045,536	10,055,532	8,408,684	9,753,830	7,222,509
Percent	7.3768%	6.6929%	6.5159%	1.1353%	4.9371%
PAYROLL FACTOR					
From Sch 6 & 7					
Montana	$ 295,737	$ 252,170	$ 229,777	$ 108,446	$ 62,843
Total	1,899,768	2,143,877	2,015,888	1,821,589	1,920,762
Percent	15.5670%	11.7623%	11.3983%	5.0534%	3.2718%
PROPERTY FACTOR					
From Sch 3-5					
Montana	$11,874,356	$11,189,290	$10,565,751	$ 7,214,205	$3,874,730
Total	17,417,592	16,615,058	14,970,861	11,190,376	7,649,961
Percent	68.1745%	67.3443%	70.5754%	64.4680%	50.6503%
Total Factors	91.1183%	85.7995%	88.4896%	71.5567%	58.8592%

(Div. 3) Aver.	30.3728%	28.5998%	29.4965%	23.8522%	19.6197%
Total Net Income	2,186,167	1,843,150	1,567,917	1,847,209	1,970,447
Income Allocated to Montana	664,000	527,137	426,481	440,600	386,596
Tax (6.75%)	44,770	35,582	31,217	29,740	26,095

Ward Paper Box challenged the application of the unitary business formula on both statutory and constitutional grounds. The State Tax Appeal Board of the State of Montana rejected both these challenges (App. A, pp. 31-40). As indicated above, the District Court upheld Appellant's statutory argument (App. A, pp. 23-30) and the Montana Supreme Court reversed, rejecting Appellant's statutory and constitutional arguments (App. A, pp. 1-10, 12-20).

The questions sought to be reviewed were raised in the District Court in Appellant's Petition for Judicial Review of the decision of the State Tax Appeal Board, filed on October 29, 1979. The questions were extensively briefed by the parties in the District Court. The District Court held that the activities of Ward Paper Box Company within the State of Montana were not part of a unitary business.

The questions presented here were raised in the initial appeal to the Supreme Court of Montana in the brief of the Taxpayer and extensively briefed by the parties. They were raised again in the Taxpayer's Petition for Rehearing. The Montana Supreme Court, in reversing the District Court, held that the Montana divisions of Ward Paper Box Company were a part of a unitary business and rejected both constitutional arguments raised by Appellant here.

Both questions raised here were raised and briefed by the Appellant in its Jurisdictional Statement and subse-

quent documents filed in its first appeal to this Court. Following remand to the Montana Supreme Court, both questions were again raised. The Montana court again held that the Montana divisions of the Ward Paper Box Company were part of a unitary business and rejected the constitutional arguments of the Appellant.

REASONS FOR NOTING JURISDICTION

This case raises two significant federal questions. The first is whether a State may constitutionally apply a unitary formula to a corporation whose operations within the taxing State form a distinct business enterprise which is functionally separate from the operations of the corporation outside the taxing State. Here, the sole connections between the corporation's Montana-based operations and its other operations are unity of ownership, the provision of some management and administrative services, and the transfer of funds. The decisions of the Montana Supreme Court, given the facts of this case, represent an extension of unitary business principle never before sanctioned by this Court. This initial question presents the Court with an opportunity to delimit the application of the unitary business principle.

The second question is whether a State may constitutionally apply a unitary business formula which apportions to the taxing State and subjects to taxation 19% to 30% of the net income of the corporation, derived from all of its operations, when the business operations within the taxing state sustained losses in all the years involved and produced no net income, when the business operations of the corporation within the taxing State produced only 1% to 7% of the Company's gross sales for the tax years in question, and when the percentage of net income apportioned to the taxing State is four to five times the percentage of sales derived from the corporation's operations

in the taxing State. The decisions of the Supreme Court of Montana eliminate the requirement of a rational relationship between the income attributed to the taxing state and the intrastate value of the enterprise.

A. *Constitutionality of the application of the unitary business principle to a corporation whose operations within the taxing State are a discrete business enterprise functionally separate from the corporation's out-of-state operations.*

Contrary to the Due Process Clause, Montana has applied the unitary business principle to the Appellant's business operations located within and outside of the State of Montana. In so doing it has taxed the extraterritorial net income of the Appellant. Application of the unitary business principle to the Appellant's business operations is constitutionally impermissible. The Appellant's business activities within Montana are functionally distinct and separate from its business operations outside the state and constitute distinct business enterprises.

The decisions of this Court require that the Appellant demonstrate, in order to establish that its income from operations outside the State of Montana is not subject to an apportioned tax in Montana, that the income was earned in the course of activities unrelated to its activities in Montana. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980). As stated more recently, in order to permit application of the principle, the out-of-state activities of the purported unitary business must be related in some concrete way to the in-state activities. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. 4987, 4989 (1983).

Here the Appellant has shown that its business of manufacturing, distributing and selling paper boxes and related products outside the State of Montana is distinct, in any business or economic sense, from its ranching activ-

ities in Montana. The Montana ranching operations are a distinct business enterprise which have no concrete relation to the Appellant's out-of-state operations.

This Court has sanctioned the use of the unitary business principle for vertically integrated companies with various components operating in several states. *Underwood Typewriter Company v. Chamberlain*, 245 U.S. 113 (1920). The principle has also been applied to vertically integrated companies operating in several countries. *Bass, Ratcliff, & Gretton v. State Tax Commission*, 226 U.S. 271 (1924). Application of the principle has been permitted in cases involving similar enterprises operating separately in several jurisdictions and having common managerial and operational resources. *Butler Brothers v. McColgan*, 315 U.S. 501 (1942). This principle has never been sanctioned for companies engaging in two distinct business operations, functionally separate, connected only by common ownership, minimal administrative ties, and flow of funds.

The Appellant's operations are not vertically integrated. Its operations do not begin with manufacture in Montana and sale in other states. Rather, its ranching activities are conducted solely within the state of Montana and its paper box manufacturing, distribution and sales activities are conducted in five other states with no relation at all to the state of Montana. Further, the in-state and out-of-state operations are totally dissimilar. There are no economies of scale such as central purchasing or advertising divisions serving both the ranching and paper box divisions. There is no exchange of equipment or transfer of personnel between the ranching and box divisions.

Early decisions of this Court established the rationale for application of the unitary business principle. Where a business earns profit through a series of transactions be-

ginning with manufacture in one state and ending with sales in another, the Legislature, in attempting to determine a fair tax burden for such a business, is faced with the impossibility of allocating specifically the profits earned by processes conducted within its borders. *Underwood Typewriter Company v. Chamberlain*, 254 U.S. at 120-121. Further, the accounting system used by a taxpayer operating in several jurisdictions may not reveal facts necessary to determine a fair tax burden. *Butler Brothers v. McColgan*, 315 U.S. at 507-508.

That rationale does not apply here. The facts of the operations conducted by the Appellant are evident. There is a distinct paper box manufacturing, distribution and sales operation and a separate ranching operation. Those operations share the minimum contacts which arise from unity of ownership. Further, there is no impossibility of allocating specifically the profits earned by processes conducted within Montana. No accounting system or corporate legal organization obscures the facts relating to the operation of the Appellant's distinct businesses.

As this Court has stated, "one must look principally to the underlying activity . . . to determine the propriety of apportionability." *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 440. The Appellant's Montana operations are completely distinct and discrete business activities having no functional relation to the Appellant's out-of-state enterprises. The decisions of the Montana Supreme Court, in determining that the Appellant's Montana operations can be deemed part of a unitary business, look past *underlying business activities* to factors unrelated to operational functions.

In claiming the ability to apply the unitary business principle to the Taxpayer, the Appellee relied upon the following factors:

1. The corporation's home office approved major management decisions for the Montana ranching operations;

2. The corporation's home office provided some administrative services to the Montana operations; and

3. The corporation's home office and the Montana ranch operations transferred funds.

The Montana Supreme Court adopted the Appellee's reasoning in determining that the Appellant's Montana operations were part of a unitary business.

The factors relied upon by the Appellee and the Montana court have no relation to the underlying business activities of the Montana operation and are insufficient to constitute a unitary business. Indeed, these elements have been found insufficient by this Court to evidence a unitary business.

1. *Management Decisions.*

The Appellee maintains that the management decisions for all divisions were made at the corporation's home office. Both the Montana State Tax Appeal Board and the State District Court found that the ranch manager made the day-to-day management decisions for the ranch divisions. Major management or financial decisions, such as those involving purchase of equipment or the buying or selling of cattle, required the approval of the chairman or president of the corporation. (App. A, pp. 25, 34).

In *Woolworth* this Court dealt with the question of whether the dividends received by a domestic corporation, from subsidiaries operating in foreign countries, could be apportioned to New Mexico. Unlike the present case, the parent and subsidiaries were involved in the same type of business activity. Major financial decisions of the subsidi-

aries, such as the amount of dividends to be paid and the creation of substantial debt, had to be approved by the parent corporation. Nonetheless, this Court concluded that the subsidiaries were not part of a unitary business. The Court found little integration of business activities and no centralization of the management of the parent and subsidiaries. It viewed as occasional oversight the parent's control of major financial decisions. *F.W. Woolworth Co. v. Taxation and Revenue Department*, 73 L. Ed. 2d at 831.

Similarly, in *ASARCO*, the Court noted with approval the decision of the Idaho Supreme Court, that a wholly-owned subsidiary engaged in an activity unrelated to the parent's business operations, was not part of a unitary business. There, the parent provided important management services to the subsidiary and the parent's direction and approval of the subsidiary's major policy decisions was required. *ASARCO, Inc. v. Idaho State Tax Commission*, 73 L. Ed. 2d at 801, n. 22.

Finally, it should be noted that the Appellant's involvement in management was not grounded on its own operational expertise or its overall operating strategy. The Appellant has no technical expertise in operating cattle ranches and left decisions relating to ranch operations to its resident manager. In this regard, the home office's involvement in management clearly differentiates this case from *Container*, where the parent's management involvement with its subsidiaries, operating in the same line of business, was grounded on its own expertise and operational strategy. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4993, n. 20.

When asked about the management responsibilities of the resident ranch managers, Mr. Louis L. Ward, the Chairman of the Board, responded that he did not "know

cattle well enough to buy them". Mr. Ward felt that he had not acquired enough knowledge of cattle operations and needed "a general manager to exercise the authority and make the decisions". In making livestock purchases the ranch manager would inform the home office that he was going to do so, and the home office would ask for an idea of how many cattle were being purchased and their approximate cost so the home office would be "sure to have the money after you have bought them to pay for them." Deposition of Louis L. Ward, p. 24.

It is particularly noteworthy that the major management decisions relied upon by Appellee were made during the time the ranches were first acquired. The Meagher County ranch was acquired in December, 1969, and the Powell County ranch in December, 1972. Neither ranch was purchased with livestock, which had to be acquired separately at later dates. The only evidence of home office involvement in cattle acquisition relates to the period of time when the ranches were being initially stocked for operation.

2. *Provision of Centralized Sevices.*

In a footnote in *Woolworth*, this Court addressed the provision of centralized services by a parent corporation to subsidiaries. There, the parent's published financial statements were prepared on a consolidated basis which included some of its subsidiaries. In finding this insufficient to evidence a unitary business, the Court quoted the following with approval from Keesling and Warren, *The Unitary Concept and The Allocation of Income*, 12 Hastings L.J. 42, 52 (1960):

> Central accounting, for instance, may result in some savings, but in most instances the amount is trifling in comparison to the income of the various series of business activities for which the accounting is performed. Alone con-

> sidered, it is too weak a connecting link to bind into one business what should be separate businesses.

F.W. Woolworth Co. v. Taxation and Revenue Department, 73 L. Ed. 2d at 831, n. 22. The Appellant's Montana operations are separate and distinct from its out-of-state operations. The administrative services provided by the corporation's home office to the Montana ranch operations are too weak a connecting link to evidence a unitary business.

3. *Transfer of Funds.*

In *Woolworth*, the New Mexico Supreme Court, in finding a unitary business, relied upon the fact that the parent had commingled its dividend income from its foreign subsidiaries with its general funds and used them for general operating purposes. In response, this Court held that such an analysis "subverts the unitary business limitation". *F.W. Woolworth Co. v. Taxation and Revenue Department*, 73 L. Ed. 2d at 827, n. 11. Expanding on this point, this Court in *Container* stated that the exchange of value necessary to relate out-of-state and in-state enterprises was not met by the "mere flow of funds arising out of a passive investment or a distinct business operation". *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4989. Here, the flow of funds between the corporation and the Montana operations clearly arose from an operation distinct in every significant business sense from the Appellant's paper box activities.

As noted in *Container*, the fund transfers between the corporation and the Montana operations served only an investment function. The transfers to the Montana operations helped maintain an investmet which otherwise would have had to borrow from outside sources. Transfers to the home office involved funds not currently required by the Montana operations. These transfers served no

operational function of the paper box divisions and are not sufficient to constitute a unitary business. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4993, n. 19.

The factors relied upon by the Appellee to justify its position herein are not sufficient, given the recent decisions of this Court, to justify application of the unitary business principle to the Appellant's business operations. Similarly, the facts involved here, which demonstrate that the Appellant's Montana operations are distinct business enterprises, reveal that the decision of the Montana Supreme Court falls outside the "realm of permissible judgment." *Norton Company v. Department of Revenue*, 340 U.S. 534, 538 (1951). As such, that judgment is not entitled to deference from this Court. The evidence in this case clearly indicates that Montana seeks to extend the scope of the unitary business principle.

By distinguishing on purely factual grounds the decisions of this Court in *ASARCO* and *Woolworth*, the Montana Supreme Court has failed to apply the correct legal standards to the facts of this case. The particular facts of this case indicate that, in permitting application of the unitary business principle to the Taxpayer, the Montana Supreme Court has erred and its judgment falls well outside the realm of permissible judgment.

The Montana operations are connected to the Appellant's other operations with the most minimal of links, all of which arise from unity of ownership. The centrality of common ownership to the position of the Appellee is shown by the decision, following remand, of the Montana Supreme Court. In attempting to distinguish *ASARCO* and *Woolworth*, the Montana court noted that those two cases involved foreign investments in the form of subsidiaries which had separate directors, officers and staff.

Here, the Montana court noted the ranch divisions were not subsidiaries but active operations of the Appellant which operated under the auspices of its board and officers. These "distinctions" mark no real difference between *ASARCO*, *Woolworth* and this case. In addition to elevating form over substance, such distinctions would subvert the constitutional limitations of the unitary business principle.

This case presents the Court with the opportunity to delimit the applicability of the unitary business principle, to give definition to the concept of discrete business enterprises, and to state that the elements relied on here are not sufficient to constitute a unitary business. Finally, this case allows this Court to address an element relied upon by the Montana court to justify its decision. The Montana court noted the treatment of Appellant's Montana operations in the income tax returns it filed in other states in which it operates. In those states the Appellant filed its tax returns under the unitary apportionment formula, which included the operations of the ranch divisions. The Montana court thought this an admission that the ranches were part of a unitary business. However, as this Court has stated, the constitutionality of a state tax should not depend on the vagaries of another state's tax policy. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 444, *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. at 228-229. The issue here is the constitutional scope of the taxing authority of the State of Montana. The actions of other states in applying the unitary business principle or of the Appellant in filing in other states cannot confer constitutional propriety upon the position of the Appellee in this case.

Here the Montana operations do not form a part of a functionally integrated enterprise and are, in fact, discrete

business enterprises having no functional connection with the out-of-state operations of the Appellant. In such circumstances, the unitary business principle cannot be applied, and the income from the Appellant's out-of-state operations cannot be apportioned to Montana without violation of the Due Process Clause of the Fourteenth Amendment. The construction of Montana's statute by its Supreme Court and its application to the Taxpayer present a clear violation of the Due Process Clause and present this Court with an important opportunity to define the limits of the unitary business principle.

B. *Constitutionality of State taxation of a corporation's net income, derived from operations both within and outside the taxing State, where the corporation's operations within the taxing State had no net income, and the net income apportioned to the taxing State is 19% to 30% of the total net income of the corporation.*

This Court has required a rational relationship between income attributed to a state by use of an apportionment formula and the intrastate values of the enterprises. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 436-37; *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 272-73 (1978). Here, the application of the three-factor formula to the operations of the Appellant, both within and outside the state of Montana, has allocated to Montana income which is "out of all appropriate proportion to the business transacted by Appellant in Montana". *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931). The formula employed by the Appellee has led to a "grossly distorted result." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968).

In the years in question, the expenses and deductions of the ranch divisions exceeded gross income and there was

no net income attributable to those divisions. During that same time, the sales of the ranch divisions constituted between 1% and 7% of the corporation's total sales, while the payroll of the ranch divisions was between 3.2% and 15.5% of the total payroll of the corporation. In each of these years, the Appellant paid a minimum corporate license tax of $50.

The formula applied by the Appellee in re-assessing the tax years in question apportioned between 19% and 30% of the total net income of the corporation to Montana. This formula converted net losses sustained by the ranch divisions into substantial amounts of net income and increased the tax due from the Appellant by between 521 and 896 times.

The Due Process Clause requires that the factors used in an apportionment formula "must actually reflect a reasonable sense of how income is generated". *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4990. Here, the percentage of allocation used by the Appellee far exceeded the percentage that Montana sales bore to the corporation's total sales. The functional value of the Montana operations, in terms of producing income taxable under the corporation license tax, can only result from sales made by the Montana operations. In each of the years involved, the gross sales of the Montana operations ranged between 1.1% and 7.3% of the total sales of the corporation. However, the total amount of net income allocated to Montana ranged between 19% and 30% of the corporation's total net income.

In the face of such figures there can be no doubt that no rational relationship exists between the income attributed to the state and the intrastate values of the enterprise. These figures also reveal that the methodology employed by the Appellee increases taxable income attributable to

Montana and the tax to be paid by the Appellant in percentages which far exceed the percentage increases which led this Court to strike down state taxes in *Hans Rees' Sons* and in *Norfolk and Western*.

In Hans Rees' Sons, this Court struck down, as arbitrary and unreasonable, a North Carolina tax which apportioned 80% of the Appellant's income to North Carolina despite the fact that the evidence tended to show that between 17% and 21% of the Appellant's income had its source in that state. Such an allocation bore no reasonable relationship or appropriate proportion to the business transacted by the Appellant in the taxing state.

This Court in *Norfolk and Western* found that Missouri exceeded its constitutional authority when its mileage formula resulted in the allocation of 8.28% of the railroad's total rolling stock to Missouri when an actual count showed that rolling stock usually employed in the state comprised approximately 2.71% of the total fleet.

The disproportionate nature of the allocation made by the State of Montana is far greater than those presented in *Hans Rees' Sons* and *Norfolk and Western*. There is no rational relationship between the income attributed to Montana and the intrastate value of the Montana activities. The Montana Supreme Court in its initial decision based its finding of a rational relationship upon its earlier finding that the Appellant's Montana operations were part of a unitary business.

> The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

App. A, p. 19.

The reasoning of the Montana Supreme Court, if left intact, virtually eliminates the requirement of a "rational relationship". Once the business is found to be unitary, any portion of the net income attributed to the taxing state is rationally related to the intrastate values. This circuitous reasoning subverts the due process limitations upon the unitary business principle and brings to mind Justice Holmes' warning in *Fargo v. Hart*, 193 U.S. 490, 499-500 (1904):

> It is obvious, however, that this notion of organic unity may be made a means of unlawfully taxing the privilege, or property outside the state, under the name of enhanced value or goodwill, if it is not closely confined to its true meaning.

Thus, this case presents this Court with an opportunity to confine the unitary business principle to its true meaning and to give further definition to the requirement of a rational relationship between income attributed by use of the formula and the intrastate values of the enterprise.

While states cannot be held, by the use of their apportionment formulas, to obtain exact measures of intrastate values, when the taxpayer evidences that the formula yields "a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make accommodations necessary to assure that its taxing power is confined to its constitutional limits." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. at 329. As such, this case presents a substantial federal question which requires plenary consideration by this Court for its resolution.

CONCLUSION

Appellant respectfully submits that the questions presented involve substantial federal issues and warrant plenary consideration by this Court following the submission of briefs and oral argument. Accordingly, probable jurisdiction should be noted.

Respectfully submitted,

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September, 1983

83-555

FILED
OCT 3 1983
ALEXANDER L. STEVAS,
CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1983

RUSSELL STOVER CANDIES, INC.,
Respondent and Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent

Appeal from:

District Court of the First Judicial District,
In and for the County of Lewis & Clark, The Honorable Peter Meloy, Judge presiding.

Counsel of Record

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Submitted: March 31, 1983
Decided: May 19, 1983

Filed: May 19, 1983
Ethel M. Harrison, *Clerk*

Mr. Chief Justice Frank I. Haswell delivered the Opinion of the Court.

The Department of Revenue (DOR) appealed the Lewis and Clark County District Court judgment reversing the State Tax Appeal Board's (STAB) determination that the Montana divisions of the Ward Paper Box Co. (Ward), appellant, now Russell Stover Candies, Inc., were taxable as part of a unitary business. The District Court held that assessment of income taxes based on appropriation of income was thus improper. This Court reversed the District Court decision. Russell Stover appealed to the United States Supreme Court which vacated our judgment and remanded the case to this Court for reconsideration in light of two United States Supreme Court cases decided subsequent to our decision.

We affirm our previous decision.

The facts are well stated in our initial opinion, Ward Paper Box Co. v. DOR (1981), __ Mont. __, 638 P.2d 1053, 38 St.Rep. 4147. However, they will be briefly set out here.

Ward filed Montana corporation license tax returns for 1971 through 1975 based on the segregated income from its Montana operations alone. DOR audited Ward's records, determined that Ward was a unitary business not entitled to separate accounting of its Montana operations and income, and assessed additional corporation license taxes against Ward by use of a three-factor formula which apportioned to Montana part of Ward's total income.

Ward protested this assessment to STAB which affirmed the assessment by DOR. Ward filed a petition for review in the District Court of Lewis and Clark County. On August 4, 1980, the District Court reversed the STAB deci-

sion. DOR appealed to this Court from the judgment of the District Court.

Ward was a Missouri corporation qualified and doing business in Montana, maintaining its principal place of business in Kansas City, Kansas. All of its common stock was owned by Louis Ward during the period in question. Ward's activities consisted of seven divisions; the divisions located outside Montana were involved in manufacture, sale and distribution of paper boxes and paper box products in the States of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consisted of two cattle ranches, one in Meagher County and one in Powell County.

For the years 1971 through 1975, Ward used the separate accounting method for filing its Montana tax returns and in each year paid the minimum corporation license tax of $50. During those years the operating costs and depreciation expenses of the Montana divisions exceeded the income earned by those divisions.

During the same time period, Ward filed tax returns under the unitary apportionment method in the other states in which it was operating, and the Montana ranch divisions were included as part of its total unitary business. In those states the losses sustained by the ranch divisions were used to offset income earned by the paper box divisions.

The facts regarding Ward's operations during the years in question are for the most part uncontested. The home office in Kansas City provided administrative services for all divisions of Ward's operation which included preparing federal and state reports, hiring the accountants to prepare tax returns, keeping the books, preparing financial statements and balancing checkbooks. Each of the divisions was charged an arbitrary figure of $60 per

month for the home office services. This figure was not based on the amount of time actually spent on each division by home office personnel.

Ward's divisions did not exchange equipment or personnel and did not purchase products jointly. There was no joint advertising program among the various divisions and no common salesmen.

There were two accounts maintained for each division, an expense bank account and a payroll account. Each division's expense bank account was maintained in a bank in Kansas City. Any monies generated by a division were deposited in that division's separate expense account. If the division did not immediately need the funds, they would be transferred from the separate division expense account into a general account and would be utilized wherever needed by any of the separate divisions. The president of the company would make the decision as to the transfer. Excess funds would be invested, if not needed by any of the divisions. A portion of the short-term investment income was attributable to funds generated in Montana, yet the portion attributable to funds earned in Montana could not be specifically identified or segregated.

If either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from Ward's general account to the ranch division's expense bank account.

The payroll account for each ranch division was maintained in a Montana bank and checks could be written on this account by the ranch manager. However, the home office personnel maintained the records, balanced the books and made the deposits.

There was some central management of the corporation. From the evidence presented at the hearing, STAB

found that the home office made all of the decisions regarding the financial affairs of the corporation and that major decisions regarding the ranches, such as the purchase of equipment and the buying and selling of cattle, required the approval of the chairman of the board or the president of the corporation.

We reversed the decision of the District Court and held that the ranch divisions were part of Ward's unitary business.

Our decision was founded upon the statutory definition of a unitary business. Section 15-31-301(2), MCA, defines the unitary business principle. It reads:

> "(2) A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses."

This rule applied throughout the entire period of the dispute, first as an administrative regulation and then as the above statute in which that regulation was codified. We concluded from the facts of the case that Ward's operation within Montana was dependent upon and contributing to its operation outside Montana. Thus, taxing apportioned income of Ward's overall operation was not violative of the due process clause.

After our decision, Russell Stover Candies, Inc., acquired all interest in Ward. It then appealed to the United States Supreme Court.

The United States Supreme Court vacated the judgment and remanded the cause to this Court for further consideration in light of two United States Supreme Court cases: F.W. Woolworth Co. v. Taxation and Revenue Dept., New Mexico (1982), 458 U.S. __, __ S.Ct. __, 73 L.Ed.2d 819, 50 USLW 4457, and ASARCO, Inc. v. Idaho State Tax Commission (1982), 458 U.S. __, __ S.Ct. __, 73 L.Ed.2d 787, 50 USLW 4962.

We affirm our initial decision.

In both of the above cases, taxpayer corporations were appealing state court decisions allowing revenue departments to include income earned through investment subsidiaries in the total "business income" to be apportioned for taxing purposes. The Supreme Court determined that the subsidiaries were separate and discrete businesses and income from such entities could not increase the income of the parent corporation that was to be apportioned. Taxing such income was a violation of the due process clause as no relationship exists between income produced by subsidiaries and the value of transacting business within the state. Mobil Oil Corp. v. Commissioner of Taxes (1980), 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510; Moorman Mfg. Co. v. Bair (1978), 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197.

In *ASARCO*, Idaho tried to levy corporation income taxes on the corporation based on income, increased by dividends, interest and stock sales from ASARCO's major interests in five foreign subsidiaries. The State Supreme Court approved this practice, and ASARCO appealed to the United States Supreme Court.

The Court applied the unitary business principle, best explained in *Mobil Oil*, supra. It found that the subsidiaries in question were separate business entities.

ASARCO had a majority interest in Southern Peru Copper Corporation, but due to a management agreement, it could not assume control of the subsidiary. Further, Southern Peru did not seek direction from ASARCO. The majority of MIM Holdings, Ltd., in Australia was owned by ASARCO, but no control was asserted nor did it elect any board members, appoint any officers or hire any staff. In two other subsidiaries, ASARCO only held minority interests, and the court held they were autonomous operations. Finally, the Mexican subsidiary was once wholly owned by ASARCO but a Mexican law forced it to divest 51 percent of its ownership.

Idaho urged the Court to expand the unitary business principle to include any income received by a parent corporation that would add to the general capital of that corporation. The Court refused this interpretation because it would result in taxing returns on any corporate investment as "business income," even though received from a totally independent entity.

The same general question was raised in *Woolworth*. The taxpayer corporation owned four foreign subsidiaries. New Mexico apportioned Woolworth's income for taxing purposes and included in such income dividends paid by subsidiaries. The corporation appealed the New Mexico Supreme Court's approval of this action.

As in *ASARCO*, the United States Supreme Court applied the unitary business principle and found the subsidiaries to be separate business entities. It determined that the potential to control is insufficient to find a unitary business. Moreover, mere financial advantage achieved from dividends does not warrant a finding that a subsidiary is part of a unitary business.

The Court concluded that the contribution to income did not result from functional integration nor centralization

of management. Functional integration was absent since the subsidiaries did all their own purchasing, staffing and training. Further, there was no centralized management. The subsidiaries had separate and distinct management personnel and training systems for such personnel. They made their own management decisions and determined their own policies. Each subsidiary catered to local needs and tastes. Each subsidiary was considered autonomous and thus a separate and discrete business.

There are certain factors that distinguish the present case from the cases decided by the United States Supreme Court. First of all, in *ASARCO* and *Woolworth*, the questioned income was derived from foreign investments in the form of subsidiaries. Here, the ranch divisions were active operations of Ward. Secondly, in form, each subsidiary is a separate and distinct business. Each had separate directors, officers and staff. On the other hand, the ranch divisions were formally part of the Ward corporation. They were subject to Ward's policies and directives and had to operate under the auspices of the board and officers. Third, and most important, there is a striking difference between the present case and the United States Supreme Court cases regarding the independence of the business entities.

In applying the standard utilized by the Supreme Court we must affirm our initial decision. To ascertain whether the subsidiaries were part of a unitary business, the Supreme Court had to determine whether there was functional integration and centralized management in the relationship between the parent and subsidiary. In other words, the Court focused on the relative independence of the subsidiary. In the case at bar, we find that the ranch divisions had very little independence from the overall Ward operation. The ranch divisions and Ward were

functionally integrated. Even though a specific product did not evolve from such integration, functional integration existed with respect to the operation of the division. There was also a large amount of centralized management. Since the ranch divisions are not separate and discrete business entities but part of a unitary business, the State was correct in taxing Ward, based on appropriation of Ward's total income.

The Montana divisions did not have the capacity to operate independent of Ward. The ranches depended upon the out-of-state operation for actual services including preparation of federal and state reports, tax returns and financial statements and hiring accountants to perform such services. The home office also kept all records and books and provided financing when funds in the ranch division expense account were insufficient. Further, the directors and officers controlled *all* divisions of Ward, including the ranch divisions. They approved or made *all* major decisions with respect to ranching activity such as buying equipment and buying and selling cattle. If such decisions were not made, the ranches simply would stand idle.

Further, we believe that Ward admitted that the ranches were part of a unitary business by utilizing the unitary business approach when filing corporation income tax forms in the other states where it operated. It considered the ranches part of its unitary business to set off income earned in those states with losses incurred in Montana. However, to minimize tax assessment in Montana, Ward asserted that it was a separate entity.

We also conclude that the standard utilized by the United State Supreme Court to determine if the subsidiaries in question were part of a unitary business is consistent with the standard codified in section 15-31-301(2),

MCA. As previously discussed, the Court focused upon the independence of the entity and whether it was capable of separate maintenance. Our statute also keys upon the dependence upon the "out of state" operation and whether the entity is capable of separate maintenance as an independent business.

Russell Stover also questions the constitutionality of the formula used to apportion to the state income to be taxed. We do not consider this issue for the following reasons. First of all, this question was not raised in the initial appeal to this Court. Second, the United States Supreme Court did not address this issue in its remand order. Finally, neither party adequately briefed this issue. In fact, the appellant mentions it for the sole purpose to insure that it is not deemed waived.

Affirmed.

FRANK I. HASWELL, Chief Justice

We Concur:
JOHN CONWAY HARRISON
DANIEL J. SHEA
L.C. GULBRANDSON
FRED J. WEBER
JOHN C. SHEEHY
FRANK B. MORRISON, JR.
Justices.

No. 81-2080

SUPREME COURT OF THE UNITED STATES

RUSSELL STOVER CANDIES, INC.,
Appellant,

v

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA.

APPEAL FROM THE SUPREME COURT OF MONTANA.

THIS CAUSE having been submitted on the statement of jurisdication and motion to dismiss,

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the above court in this cause is vacated with costs, and that this cause is remanded to the Supreme Court of Montana for further consideration in light of *F.W. Woolworth Co.* v. *Taxation & Revenue Department of New Mexico*, 458 U.S. __ (1982); and *ASARCO, Inc.* v. *Idaho State Tax Commission*, 458 U.S. __ (1982).

IT IS FURTHER ORDERED that the appellant, Russell Stover Candies, Inc., recover from Department of Revenue of the State of Montana Two Hundred Dollars ($200.00) for its costs herein expended.

October 4, 1982

Clerk's costs: $200.00

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1981

WARD PAPER BOX COMPANY, A Missouri corp.,
Respondent and Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent

Appeal from:

District Court of the First Judicial District,
In and for the County of Lewis & Clark, The
Honorable Peter Meloy, Judge presiding.

Counsel of Record

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Montana

Submitted: September 21, 1981
Decided: December 21, 1981

Filed: December 21, 1981

Thomas J. Kearney, *Clerk*

Mr. Chief Justice Frank I. Haswell delivered the Opinion of the Court.

This is an appeal by the Department of Revenue (DOR) from a judgment of the District Court of Lewis and Clark County vacating an assessment of additional corporation license taxes against the Ward Paper Box Company (Ward) for the years 1971 through 1975. We reverse.

Ward filed Montana corporation license tax returns for the years in question based on the segregated income from its Montana operations alone. DOR audited Ward's records, determined that Ward was a unitary business not entitled to separate accounting of its Montana operations and income, and assessed additional corporation license taxes against Ward by use of a three factor formula which apportioned to Montana a part of Ward's total income.

Ward protested this assessment to the State Tax Appeal Board (STAB). STAB affirmed the assessment by DOR. Ward filed a petition for review in the District Court of Lewis and Clark County. On August 4, 1980, the District Court reversed the STAB decision. DOR now appeals from the judgment of the District Court.

Ward is a Missouri corporation qualified and doing business in Montana, maintaining its principal place of business in Kansas City, Kansas. All of its common stock is owned by Mr. Louis Ward. Ward's activities consist of seven divisions; the divisions located outside of Montana are involved in manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consist of two cattle ranches, one in Meagher County and one in Powell County.

For the years 1971 through 1975, Ward used the separate accounting method for filing its Montana tax

returns and in each year paid the minimum corporation license tax of $50. During those years the operating costs and depreciation expenses of the Montana divisions exceeded the income earned by those divisions.

During the same time period, Ward filed tax returns under the unitary apportionment method in the other states in which it was operating and the Montana ranch divisions were included as part of its total unitary business. In those states the losses sustained by the ranch divisions were used to offset income earned by the paper box divisions.

The facts regarding Ward's operations during the years in question are for the most part uncontested. The home office in Kansas City provided administrative services for all divisions of Ward's operation which included preparing federal and state reports, hiring the accountants to prepare tax returns, keeping the books, preparing financial statements and balancing check books. Each of the divisions was charged an arbitrary figure of $60 per month for the home office services. This figure was not based on the amount of time actually spent on each division by the home office personnel.

Ward's divisions did not exchange equipment or personnel and did not purchase products jointly. There was no joint advertising program among the various divisions and no common salesmen.

There were two accounts maintained for each division, an expense bank account and a payroll account.

Each division's expense bank account was maintained in a bank in Kansas City. Any monies generated by a division were deposited in that division's separate expense account. If the division did not immediatley need the funds, they would be transferred from the separate division ex-

pense account into a general account and would be utilized wherever needed by any of the separate divisions. The president of the company would make the decision as to the transfer. Excess funds would be invested, if not needed by any of the divisions. A portion of the short-term investment income was attributable to funds generated in Montana, yet the portion attributable to funds earned in Montana could not be specifically identified or segregated.

If either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from Ward's general account to the ranch division's expense bank account.

The payroll account for each ranch division was maintained in a Montana bank and checks could be written on the account by the ranch manager. However the home office personnel maintained the records, balanced the books, and made the deposits.

There was some central management of the corporation. From the evidence presented at the hearing, STAB found that the home office made all of the decisions regarding the financial affairs of the corporation and that major decisions regarding the ranches, such as the purchase of equipment and the buying and selling of cattle, required the approval of the chairman of the board or the president of the corporation.

Based on its findings regarding Ward's operation, STAB held that Ward was a unitary business and that the DOR had properly assessed the additional taxes against Ward. The District Court reversed the STAB decision, and DOR appeals.

Two issues are raised on appeal:

1. Whether the Montana ranch divisions were part of Ward's unitary business requiring Ward to apportion its

total income for Montana corporation and license tax purposes.

2. Whether the proper standard of review was used by the District Court in reviewing the STAB decision.

In order to resolve the first issue we must look at the pertinent statutory language in effect for the years 1971 through 1975, the years for which Ward was assessed additional corporation license taxes.

In 1971 and 1972 section 84-1503, R.C.M.1947, provided in pertinent part:

> "If the income of any corporation from sources within the state cannot be properly segragated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable. . ."

A 1973 amendment of this section substituted the words "department of revenue" for "board of equalization."

The section was amended again in 1974 and as amended stated in part:

> "A corporation engaged in a unitary business within and without Montana must apportion its business income. . . A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent business[es]."

This same rule was found in the administrative regulations prior to the 1974 amendment of section 84-1503. The regulations which contained this rule were effective for tax years beginning on or after January 1, 1967.

In Mont. Dept. of Rev. v. Am. Smelting & Refining (1977), 173 Mont. 316, 567 P.2d 901 (hereinafter cited as ASARCO), this Court held that the purpose of the 1974 amendment was to clarify the statute; we stated that the unamended version of the statute was not in conflict with the regulations in effect prior to the 1974 amendment and we upheld the administrative regulations. Therefore, the rule quoted above applied during the entire period in dispute, first as an administrative regulation and then as a statute in which that regulation was codified.

If Ward was a unitary business, it was required to apportion its business income for the purpose of the Montana corporation license tax. If the business was unitary, the income from sources within Montana could not be "properly segregated" from income without the state.

Segregating the income by source does not necessarily "properly segregate" the Montana income from the out-of-state income thereby making the use of the separate accounting method proper, any statement in *ASARCO*, supra, that might be interpreted to the contrary notwithstanding.

The United States Supreme Court has declared that a state is not precluded from taxing a corporation under the apportionment method even if the source of income may be ascertained by separate geographical accounting as long as the intra-state and extra-state activities are part of a single unitary business. Mobil Oil Corp. v. Com'r of Taxes of Vermont (1980), 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510.

If the operation of Ward's business within Montana was dependent upon or contributory to its operation outside the state or if the Montana ranch divisions and the out-of-state paper box divisions were closely allied and not capable of separate maintenance as independent businesses, then the Montana ranch divisions were part of a "unitary business."

We find from the facts of this case that Ward's operation within Montana was dependent upon and contributing to its operation outside Montana. The Montana divisions were dependent upon the out-of-state operation for central services which included the preparation of federal and state reports, the hiring of accountants to prepare tax returns, the preparation of financial statements, the keeping of records, and the balancing of check books; for financing when funds in the ranch divisions' expense bank account were insufficient to meet the divisions' expenses; and for major management decisions which included the purchase of equipment and the buying and selling of cattle.

Ward's operation within Montana also contributed to its operation and net income outside the state. The Montana divisions furnished Ward with a substantial tax write-off thereby saving the corporation as a whole a substantial amount in taxes. Also a portion of Ward's short-term investment income was attributable to funds generated in Montana.

Since Ward's operation in Montana was both dependent upon and contributory to its operation outside the state, the Montana ranch divisions were part of Ward's unitary business during the years in question.

The respondent Ward contends that the DOR's assessment of additional taxes against it in this case is an attempt to subject income earned by Ward in other states to

the Montana corporation license tax in violation of the due process clause of the Fourteenth Amendment of the United States Constitution. We disagree.

The United States Supreme Court recently addressed this issue in *Mobil Oil Corp.*, 445 U.S. at 436-437, stating:

> "It long has been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. (Cite omitted.) '[T]he entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing instate aspects of interstate affairs.' (Cite omitted.) For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise. (Cite omitted.)"

The "minimal connection" or "nexus" is established "if the corporation avails itself of the 'substantial privilege of carrying on business' within the State. . ." *Mobil Oil Corp.*, 445 U.S. at 437, citing Wisconsin v. J.C. Penny Co. (1940), 311 U.S. 435, 444-445. Ward clearly availed itself of this privilege in Montana.

The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

The second issue raised by appellant DOR is whether the District Court used the proper standard of review of

STAB's findings and ruling. Since we are reversing the District Court judgment, this issue is irrelevant to a determination of this appeal.

The judgment of the District Court is reversed and the order of the State Tax Appeal Board entered October 1, 1979 in Docket No. CT-1978-3 is reinstated.

FRANK I. HASWELL, Chief Justice

We Concur:
GENE B. DALY
FRED J. WEBER
FRANK B. MORRISON, JR.
JOHN C. SHEEHY
Justices.

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

JUDGMENT ON REVIEW OF AGENCY ACTION

Filed: August 12, 1980

This matter involved an appeal from an Order of the State Tax Appeal Board entered October 1, 1979, in Docket No. CT-1978-3 and came before this Court on a Petition for Judicial Review by the taxpayer pursuant to Section 2-4-702, MCA, and Section 15-2-303, MCA, containing a statement of facts and specifying the grounds for review, and was filed pursuant to applicable law; and

This Court reviewed the record, heard oral argument of counsel, reviewed the written briefs and after having taken the matter under advisement, did on August 4, 1980, issue its Opinion and Order, a copy of which is attached hereto marked Exhibit "1" and which is by this reference incorporated herein;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Order of the State Tax Appeal Board in Docket No. CT-1978-3 be, and it is hereby reversed because the substantial rights of the Appellant taxpayer have been prejudiced as more particularly set

forth in Exhibit "1" and because the decision is clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the case be remanded to the State Tax Appeal Board for further proceedings in accordance with Exhibit "1".

DATED this 12th day of August, 1980.

GORDON R. BENNETT, District Judge

EXHIBIT "1"

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

OPINION and ORDER

Filed: August 4, 1980

This cause concerned the taxing of income by the State of Montana of Ward Paper Box Company.

It is agreed that the 14th Amendment of the United States Constitution prohibits a state from asserting a tax on income derived from business conducted beyond its border. However a situation arises wherein a corporation operates both within and without the state. In such a situation the legislature has provided one of two methods of taxation. One method is known as "separate accounting" and the other as the formula method.

Under the "separate accounting" method the corporation's activities within an individual state are treated entirely separate from the business activities outside the state.

The "formula" method treats the business activities within the state as part of the over-all business activities carried on by the corporation and considers the business

as "unitary" and apportions the taxable amount generally using three factors of value of property, amount of sales and amount of payroll.

The United States Supreme Court has considered the problem of the state's right to tax multi-state corporate activities but no clear rule has been established. However the formula method has been approved once it is determined that the business is unitary. Montana has by Supreme Court decision approved the formula method, the latest decision being *Department of Revenue v. American Smelting and Refining Company*, __M__, 567 P2d 901.

The question at bench is whether or not the petitioner can be classified as a "unitary operation."

Section 15-31-301 MCA provides the statutory definition of a "unitary" business as follows:

> "...a business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of a business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as a separate business."

The essential facts of Ward Paper Box's activities within and without the state are as follows:

1. Ward Paper Box Company is a Missouri chartered corporation and has its principal place of business in Kansas City, Kansas.

2. It has qualified to do business in the State of Montana.

3. The corporation is operated by divisions.

4. All out of Montana business concerned the manufacture, sale and distribution of paper boxes and paper box

products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia.

5. The sole Montana activity were two cattle ranch divisions, one in Meagher County and one in Powell County.

6. As to the ranching activities, the resident ranch manager made the day to day decisions but the major decisions such as the purchase of equipment, buying and selling of cattle required the approval of Mr. Lou Ward, Chairman of the Board, or Mr. Don Bowers, the president. The home office in Kansas City, through corporate personnel, made all decisions regarding the financial affairs of all divisions; prepared all federal and state reports (not including motor fuel reports); hired the accountants to prepare tax returns; kept all books; prepared all financial statements and balanced all checkbooks.

7. All divisions had the same operational supervision but there was no joint advertising program, no common salesmen, no common guaranties. Personnel of the various divisions did not move from one division to another, including managing staff. The divisions did not exchange equipment and did not purchase products jointly.

8. Each division had a payroll and expense account maintained in a bank in Kansas City. Whenever moneys were generated by a division they were deposited in the separate division account. If the division did not immediately need the funds, they would be transferred from the separate division's expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The president would make the decisions as to transfer.

The Board of Tax Appeal concluded that there existed a unitary business consisting of two business activities,

namely ranching and paper box activities; that the ranch divisions were dependent on the out of Montana operation; that the ranch divisions were contributory to the operation of the out of Montana operations; that the ranch divisions' operations were closely aligned with the out of state operations; and that the ranch divisions "are not capable of separate maintenance as independent businesses from the operations of activities located outside the state."

The question before this Court is whether or not the business of Ward Paper Box is "unitary" within the meaning of the case law and the Montana statute. There is no essential dispute between the Department and the box company as to the facts of the relationship. The Department characterizes the Montana statutory definition of "unitary" as being composed of three separate tests and if the factual situation meets any one of the tests, the business activity is unitary and that the formula method is appropriate. These tests are (1) dependence, (2) contribution, (3) close alliance and not capable of separate maintenance.

As to the first test, it appears that there is some dependence by the ranch divisions on the out of state activities, although it appears that the ranch divisions could be separately maintained.

As to the second test, there is contribution in that the losses generated by the Montana operations are used by the out of state division for tax purposes and that any funds not used by the ranch divisions, if any, may produce income which could inure to the benefit of the out of state activities.

As to the third test, it appears that there is a close alliance in management and "cash flow" between the ranch divisions and the out of state activities.

The appellant contends that it has the right to make the tax return as it did, namely by separate accounting and that the conclusions of the State Tax Appeal Board are clearly erroneous in that they are not supported by substantial evidence within the meaning of Section 2-4-704 MCA.

As before stated and it is agreed that it is fundamental that a state has no power to impose a tax on income earned outside the state. Where, however, in the instance of an entity operating in more than one state the formula method can be used *if the activities can be classified as "unitary."*

The United States Supreme Court has, in the course of considering the question of unitary activities, used language which is appropriate for the facts considered and which sheds some light on the situation here considered.

In *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, the court held that the out of state income of a business that operates in more than one state is subject to examination by the taxing state only because of "the impossibility of allocating the profits earned by the processes conducted within its borders." (Underlining supplied).

In *Mobile Oil Corporation v. Commissioner of Taxes of Vermont* [sic], 48 U.S. Law Week 4306, the court said:

> "For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal' connection between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise."
>
> "Nor do we find particularly persuasive Mobile's attempt to identify a separate business in its holding company function. So long as dividends from subsidiaries and affil-

> iates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity not at the form of investment, to determine the propriety of apportionability." (Underlining supplied)
>
> "Where the business activities of the dividend payor have nothing to do with the activities of the recipient State, due process consideration might well preclude apportionability, because there would be no underlying unitary business."

In *Exxon Corp. v. Department of Revenue of Wisconsin* (United States Supreme Court, decided June 10, 1980), the court approved the apportionability of the Wisconsin statutes in a situation where Exxon was vertically integrated with a corporate structure divided into three parts namely Corporate Management, Coordination and Service Management, and Operations Management. The Wisconsin operation consisted of marketing products only. The court reiterated its previous holding that a company's internal accounting techniques are not binding on a state for tax purposes and restated the general rule that the due process clause imposes two requirements for state taxation "a minimal connection or nexus between the interstate activities and the taxing state, and *a rational relationship between the income attributed to the state and the intrastate values of the enterprise.*"

The appellant contends that a fundamental error occurred. It argues that the statutory standard of taxation arises from the words "income derived from or attributable to Montana sources" Section 15-31-101(3) MCA and it is only where necessary that 15-31-301 comes into effect (attribution of income). The appellant contends that the income sought to be taxed must have a Montana source — that is an activity must take place in Montana which contributes to income or upon which the overall

operation depends to produce income in a real way. It points out that the two operations of the tax payer here are separate, they do not share goods, supplies, sales, advertising, machinery, employees, technical assistance. It urges that the only real connections is that the monies originate at the same point and return to the same point which has been referred to as "cash flow."

The factual situation as disclosed by the record demonstrates that there is no impossibility of allocating the income between the Box activities and while there is minimal nexus between Box activities and the ranch activities, there is no real contribution by the ranches to the income of the Box activity.

To preserve the administrative function, the standard of review by the courts has been limited by statute, namely Section 2-4-704 MCA, wherein it states as follows:

> "(2) the court may not substitute its judgment for that of the agency as to the weight of evidence on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions or decisions are:
>
> (a) in violation of constitutional or statutory provision;
>
> (b) in excess of the statutory authority of the agency;
>
> (c) made upon unlawful procedure;
>
> (d) affected by other error of law;
>
> (e) clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;
>
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
>
> (g) because findings of fact, upon issues essential to the decision, were not made although requested."

The Montana Supreme Court has in *Brurud v. Judge Moving and Storage Co., Inc.*, 172 M 249 set for the definition of "clearly erroneous" as follows:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

The Montana State Board of Tax Appeals has found the business to be unitary and it is the view of this Court that such finding is clearly erroneous. Fundamentally the rationale of the unitary tax concept as approved by the United State Supreme Court directs the look of the court to the "underlying activity not at the form of investment, to determine apportionability." (*Mobile Oil Corporation v. Commissioner of Taxes of Vermont*, supra.) [sic].

In the controversy under consideration here the activities of the appellant which produce income unrelated to the Montana activities, and which the State seeks to tax, are distinctly separate. The contribution of the ranch activity to the income from the paper box activity, if any, is slight.

The position of the State here is an unwarranted extension of the "unitary concept" and violates the basic rationale of the unitary concept.

This Court finds and concludes that the decision of the State Tax Appeal Board is clearly erroneous and therefore should be reversed and remanded to the State Tax Appeal Board for further proceedings in accord with this opinion.

Let judgment be entered accordingly.

Dated this 4th day of August, 1980.

PETER G. MELOY, District Judge

cc to: Counsel of record

Docket No. CT-1978-3

BEFORE THE STATE TAX APPEAL BOARD OF THE STATE OF MONTANA

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Hearing on the appeal of Ward Paper Box Company, pursuant to Sections 2-4-601 and 15-2-302, M.C.A., came on regularly for hearing before the Board on April 23, 24, 1979, in the City of Helena, Montana, from a decision of the Department of Revenue denying Appellant's request to set aside the deficiency assessment levied against said Appellant and the decision of the Department of Revenue in treating Appellant as a unitary operation and requiring formula apportionment of all of Appellants income for the taxable years 1971 through 1975, the Appellant, Ward Paper Box Company, appearing through its attorney, Ward A. Shanahan, of the firm of Gough, Shanahan, Johnson & Waterman, Helena, Montana; and the Department of Revenue being represented by Terry B. Cosgrove, Special Assistant Attorney General; and the Board having heard the testimony and have examined all of the evidence and the briefs offered by all parties, and the Board being fully advised in the premises, does hereby make its Findings of Fact, Conclusions of Law and Order as follows:

FINDINGS OF FACT

I.

Ward Paper Box Company is a corporation organized and existing under the laws of the State of Missouri, duly authorized and qualified to do business in the State of Montana with its principal place of business at 3150 Chrysler Road, Kansas City, Kansas. The President of the company, Mr. Don E. Bowers, has his office there.

II.

The company operated in its corporate capacity in Montana and received services from the State of Montana, through its divisions, the Castle Mountain Ranch Division in Meagher County, Montana, which was purchased on December 1, 1969, and the Rock Creek Cattle Company Division in Powell County, Montana, which was purchased on December 1, 1972. These divisions produce livestock, hay, forage and other crops solely in Montana and operate in Montana and no other state.

III.

The corporation also operated several paper box divisions which, during the taxable years in question, manufactured, distributed and sold paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. During the audit period, none of these divisions in any way engaged in the business of manufacturing, distributing or selling paper boxes or paper box products in the State of Montana or engaged in the business of agriculture or the business of producing livestock, hay, forage or other crops in the state of Montana, or in any other state.

IV.

The Department of Revenue, pursuant to a notice of deficiency, assessed a deficiency against the taxpayer

under the Montana Corporation License Tax for the years 1971, 1972, 1973, 1974 and 1975.

V.

The taxpayer had been filing its returns in the state of Montana utilizing the method of separate accounting.

VI.

The Taxpayer's ranching activities are limited solely to the state of Montana; but said Taxpayer has filed its tax returns in the states of Missouri, Kansas, Colorado, South Carolina and Virginia under the method of unitary apportionment of its total net income, including as a portion of its regular business income, the income and expenses from the ranch activities and apportioning that income to the other states.

VII.

In the "sales factor" of the three-factor formula used by the Department of Revenue, Montana sales of livestock, hay and some gravel are compared with all sales, including sales in other states of paper boxes and paper box products for the taxable years in question.

VIII.

In the "payroll factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the salaries and benefits paid to ranch supervisors, supervisory personnel and all employees in the state of Montana were compared to all employees of the company everywhere.

IX.

In the "property factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the property owned and located in the State of Montana is compared to the property owned by the company and located elsewhere.

X.

During the period of the audit, the sales factor representing the Montana sales, equaled the following percentage of the taxpayers total sales: 1971 - 4.9%; 1972 - 1.1%; 1973 - 6.5%; 1974 - 6.6%; and 1975 - 7.3%.

XI.

During the period of the audit, the payroll factor representing the Montana payroll, equaled the following percentages of the taxpayers total payroll: 1971 - 3.2%; 1972 - 5.9%; 1973 - 11.3%; 1974 - 11.7%; and 1975 - 15.5%.

XII.

During the period of the audit, the property factor representing the Montana property, equaled the following percentages of the taxpayers total property: 1971 - 50.6%; 1972 - 64.4%; 1973 - 70.5%; 1974 - 67.3%; and 1975 - 68.1%.

XIII.

The Montana payroll, property and sales during the period of the audit equaled the following percentages of the companys total payroll, property and sales: 1971 - 19.6%; 1972 - 23.8%; 1973 - 29.4%; 1974 - 28.5%; and 1975 - 30.3%.

XIV.

During the years in question, the ranch manager had decision making authority on the day to day ranch operations; however, for matters outside of the day to day activities, including, but not limited to, the purchase of equipment, or buying or selling cattle, such decisions required approval from either Mr. Louis Ward, Chairman of the Board or Mr. Don Bowers, President of the company.

XV.

The home office, located in Kansas City, Missouri, made all decisions regarding the financial affairs of the

corporation, the home office also provided and prepared for all of the divisions including Montana, the federal and state reports (other than motor fuel) which were filed; the home office also hired the accounting firm of Touche and Ross to prepare all federal and state tax returns; the home office also kept all of the books, prepared all financial statements, and balanced all checkbooks. All divisions of the corporation, including the ranch divisions, were charged an arbitrary figure of $60.00 per month for all home office services. This figure was not based upon any allocation of time spent by any of the home office personnel, and had been in use prior to the time of the audit.

XVI.

The Montana divisions could not account for their total actual expenses in as much as an arbitrary $60.00 a month figure is charged for home office services, which bears no relation to the actual time expended, and was allocated throughout the company on that same basis without any regard to what the actual charge should be to a particular division.

XVII.

The Chairman of the Board and principal stockholder, Mr. Louis L. Ward, visited Montana the following listed number of times during the years in question, according to a log kept of the movements by the company aircraft:

1971 — 8 trips to Helena, 1 to Billings
1972 — 12 trips to Helena
1973 — 5 trips to Helena
1974 — 6 trips to Helena
1975 — 6 trips to Helena

XVIII.

A Mr. J. Tschudy was hired by the company as a consultant in ranch properties in 1968. He visited the Castle Mountain Ranch in Meagher County several times. His

permanent office was in Kansas City, Kansas. Mr. Tschudy died in 1972, his compensation was included in wages and salaries claimed as deductions for the Montana ranch operations in 1971 and 1972.

XIX.

During the period of the audit the ranch and box divisions had the same operational supervision, there was no joint advertising program among any of the divisions of the corporation, there were no common salesmen for any of the divisions of the corporation, there were no common guarantees for any of the divisions of the corporation, personnel from the various divisions did not move from one division to another, including managing staff; the various divisions did not exchange equipment; the divisions did not purchase products jointly whether for the ranch or box operations.

XX.

During the period of the audit the ranch personnel consisted of employees working exclusively on specific ranch projects; no accounts, bookkeepers or office employees were employed at either ranch divisions during the period of the audit.

XXI.

Each division had a payroll account and an expense account. The expense accounts were maintained in a bank in Kansas City, and whenever monies were generated by a division they were deposited in the separate division expense account. If the division did not immediately need the funds, they would be transferred from the separate division expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The determination of whether or not funds would be transferred from the divi-

sion expense account to the Ward general account was made by the President of the company.

XXII.

The ranch divisions maintained a payroll account in a Montana bank, however the ranch manager did not know the balance of the account, he merely would write the payroll checks and forward the information to the home office where the records were maintained, the books balanced and deposits originated. The ranch manager would not make deposits in the payroll account, those decisions were made at the home office. Limits on the size of a check a ranch manager could write were set by the Board of Directors of the Company.

XXIII.

During the period of the audit, monies would be transferred from the separate division expense account, including the Montana divisions, to the Ward general account for the purpose of making short term investments.

XXIV.

The investment income earned by the taxpayer, a portion of which was attributable to the funds generated in Montana, was reported only in the State of Missouri, and could not be segregated as to source including that portion attributable to the income generated in Montana.

XXV.

The ranch operations did not generate sufficient cash inflow generated from the company's other operations, during the audit period: 1971 - $752,693.00; 1972 - $4,535,597.00 — this did include $3,300,000.00 for the purchase of the Rock Creek Division, so the actual cash inflow needed apart from the ranch acquisition was $1,235,597.00; 1973 - $938,931.00; 1974 - $1,268,146.00; and 1975 - $819,984.00 [sic].

XXVI.

Funds exceeding those generated from the ranch divisions necessary to pay ranch expenses would be transferred from the Ward general account to the ranch expense account.

XXVII.

Funds from the ranch divisions when transferred to the Ward general account were co-mingled with other funds of the company.

XXVIII.

The taxpayer never requested under the provisions of Section 15-31-312, M.C.A., for the use of a different apportionment formula or for modification of the formula, only for the right to use separate accounting.

XXIX.

The taxpayer has had the opportunity to examine all information utilized by the Department in making its determination of the deficiency assessment.

CONCLUSIONS OF LAW

I.

The taxpayer has income arising from business activities both within and without the state of Montana.

II.

The corporation is engaged in two business activities.

III.

The operation of the ranch divisions within the state is dependent upon the operations of the company located outside the state.

IV.

The operation of the ranch divisions within the state is contributory to the operation of the divisions outside the state.

V.

The operation of the ranch divisions within the state is closely aligned with the operations of the taxpayer located outside the state.

VI.

The operations of the ranch divisions are not capable of separate maintenance as independent businesses from the operations of the activities located outside the state.

VII.

A flow of goods within a corporation is not necessary in order to have a unitary business operation.

VIII.

The taxpayer is operating a unitary business as defined by the statutes and regulations of the Corporation License Tax Act.

IX.

A unitary business is not able to properly separately account for its income or expenses.

X.

The taxpayer cannot properly segregate income or expenses directly attributable to the State of Montana.

XI.

The taxpayer has been improperly filing on the separate accounting basis, and is required to file on the apportionment method, utilizing the factors of payroll, property and sales.

XII.

The Department of Revenue has properly taxed income which is in fact derived from or attributable to Montana sources.

XIII.

The formula utilized by the Department in computing the net income attributable to the taxpayer, is ration-

ally related to the values provided by the state to the taxpayer.

XIV.

The deficiency assessment levied by the Department and its determination that the operations of the taxpayer are unitary, does not exceed the power of the Department to access [sic] and levy a tax pursuant to the laws of the State of Montana, and does not result in a taxation upon income earned in other states, and is not a taking of property without due process of law in violation of either the 5th or 14th Amendments of the Constitution of the United States and the applicable provisions of the Montana Constitution.

XV.

The regulation 42-2.6(1)-S6270, was properly adopted and effective for the years in question.

XVI.

The regulation 42-2.6(1)-S6450 and regulations 42-2.6(1)-S6280 and 42-2.6(1)-S6450 do not exceed the scope of the authority of the Department of Revenue, and were properly adopted and effective for the years in question.

XVII.

The action of the Department of Revenue in no way denies the taxpayer equal protection under the laws guaranteed to it by the 14th Amendment to the Constitution of the United States.

XVIII.

That the method utilized by the taxpayer of filing its corporate returns in other states is relevant to the inquiry of determining in the State of Montana how the taxpayer should be reporting.

XIX.

That the taxpayer has not properly reported its income in accordance with the Montana Corporation License Tax effective for the taxable years in question.

ORDER

Based on the above Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED:

1. That the taxpayers appeal from the decision of the Department of Revenue is denied.

2. That the Appellant herein pay all Montana Corporation license taxes herein assessed, and interest, as properly imposed by the laws of the State of Montana.

DATED this 1st day of October, 1979.

BY ORDER OF THE STATE TAX APPEAL BOARD

HELEN M. PETERSON, Chairman

ROBERT S. RAUNDAL, Member

JAMES A. STEFFECK, Member

IN THE MATTER OF THE PROTEST OF
WARD PAPER BOX COMPANY

Proposed Deficiency Assessments of
Corporate License Tax For Calendar Years
1971, 1972, 1973, 1974 and 1975

HEARING OFFICER:

John Clark, Administrator, Research Division, Department of Revenue, Mitchell Building, Helena, Montana 59601

DATE OF HEARING:

December 28, 1977, at 10:00 o'clock a.m., continued to April 6, 1978, at 9:00 o'clock a.m.

PLACE OF HEARING:

Mitchell Building, Helena, Montana

PRESENT FOR THE TAXPAYER:

Mr. Ward Shanahan, of Gough, Shanahan, Johnson & Waterman, First National Bank Building, P.O. Box 1686, Helena, Montana 59601

PRESENT FOR THE DEPARTMENT:

Mr. Terry Cosgrove and Mr. Robert Corcoran, Counsel for the Montana Department of Revenue

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The controversy in question arises out of the determinations of Montana Corporate License Tax dated June 1, 1977 concerning Ward Paper Box Company's liability for the years ending December 31, 1971 through December 31, 1975 inclusive. These determinations were based on an audit conducted by staff of the Corporation License Tax Division for the Montana Department of Revenue for the State of Montana.

The foregoing letters of determination disclose the following corporate license tax liability due the State of Montana from Ward Paper Box Company (hereafter Ward) as of May 30, 1977.

	1971	1972	1973	1974	1975
Tax due per audit	$26,045.	$29,690.	$31,167.	$35,532.	$44,770.
Interest at 9%					
5/15/72-5/30/77	11,818.				
5/15/73-5/30/77		10,800.			
5/15/74-5/30/77			8,532.		
5/15/75-5/30/77				6,529.	
5/15/76-5/30/77					4,197.
	$37,863.	$40,490.	$39,699.	$42,061.	$48,967.
GRAND TOTAL	$209,080.				

By letter dated June 29, 1977 received by the Montana Department of Revenue (hereinafter the Department) on June 29, 1977, Mr. Ward A. Shanahan, counsel for Ward, filed a protest against the foregoing determinations and requested an opportunity to have an oral hearing and the right to present additional evidence.

Mr. Shanahan contended that the company operates in Montana through two divisions, Castle Mountain Ranch division and Rock Creek Cattle Company division an agricultural business producing livestock, hay, forage and other crops. Mr. Shanahan further contended that the Paper Box Division is a wholly separate division which did not engage in business in the State of Montana or engage in the business conducted by the divisions in the State of Montana. Further, that the income of the taxpayer from sources within the state is properly segregable; that regulation 42-2.6 (1)-S.6270 was not adopted or effective for the years 1971 and 1972; that the same regulation purports

to adopt a uniform act which has not been adopted by the legislature; that regulations 42-2.6 (1)-S.620 through 42-2.6 (1)-S.6450 exceeded legislative authority and therefore was not effective in the years in question; that the activities of the taxpayer are separate and distinct from the other activities not part of a unitary business and the business conducted within the state is not dependent upon or contributory to the business conducted outside the state; that the elements of common ownership; use of centralized facilities, centralized management and decision making are not sufficient to establish unitary business; and that the actions of the Department exceeded the regulations of the Department, exceed statutory authority and are not based upon sufficient facts and are otherwise arbitrary.

As a result of the protest, an informal conference was held on August 22, 1977, between representatives of Ward and the Corporation License Tax Division at which time it was determined that there was no prospect of a settlement of this matter and the taxpayer by letter dated September 16, 1977 further requested an oral hearing on this matter.

By letter dated November 1, 1977 Mr. Shanahan was notified of the hearing which was subsequently held on December 28, 1977. At the hearing questions were raised as to the propriety of Mr. Foster conducting the informal hearing of this matter and to the nature and procedure of the hearing.

At the hearing the taxpayer agreed to supply tax returns filed in other states in which it operates its box divisions but no cattle operations, and filed an additional protest of the proposed action of the Corporation License Tax Division.

The hearing was adjourned until a further date.

By letter dated March 15, 1978 Mr. Shanahan was informed that the hearing would be reconvened but that due to the allegation that Mr. Foster could not properly hear this matter, Mr. John Clark, Administrator, Research Division, was appointed as the informal hearings officer.

The hearing was reconvened on April 6th at 9:00 o'clock at which time the taxpayer was given the opportunity to present any additional information relating to the proposed deficiency.

During the foregoing proceedings, Ward has been given every opportunity to produce any documents or other evidence it wished to have considered in conjunction with the hearing. The department relied on the materials submitted by the taxpayer to resolve the questions at issue at the hearing.

It is important to again review the nature of the hearing contemplated by section 84-1508.1. This question was specifically raised and decided by the Montana Supreme Court in the case of *W.R. Grace and Co., vs. the Department of Revenue of the State of Montana*, 34 St. Rep. 713, __P2d__ (1977). There the Montana Supreme Court very clearly defined the scope and extent of this hearing when it said:

> "As stated above, Section 84-1508.1 does not provide a true adversary hearing, but only for a presentation of additional evidence by the taxpayer and a reconsideration by DOR thereafter." Page 716.

Under this mandate from the Supreme Court of Montana, it is necessary then to weigh the additional information provided by the taxpayer to determine if there is just cause for a reconsideration of the proposed assessment.

The taxpayer has not questioned the calculations of the Department in proposing the deficiency assessment but

has limited its arguments solely to the legal authority of the Department to require the taxpayer to file a unitary tax return.

The authority of the Department to require the filing of a unitary tax return is derived in Section 84-1503 R.C.M. 1947 and the regulations adopted by the Department. Under the statute 84-1503, prior to its amendment in 1974, a corporation was required to file its returns based on the separate accounting method only if, "the income of any corporation from sources within the state cannot be *properly* segregated from income without the state". To determine whether a corporation can properly separately account, it is necessary to look at the regulations which were in effect prior to the 1974 amendment. These provide that any corporation which conducts a unitary business within and without the State of Montana must apportion its business income. The regulations further provide that "a business is unitary when the operation of the business within the state is *dependent upon*. . . the operation of the business outside the state". That language was subsequently enacted into the amended section of 84-1503.

Whether or not those regulations were valid was decided by the Supreme Court of Montana in the case of *Montana Department of Revenue vs. American Smelting and Refining Company*, 34 St. Rep. 597, __P2d__ (1977), wherein the Court stated:

> "The crux of this entire case is the interpretation of Section 84-1503 and DOR regulations 1001-1020. There is no merit in ASARCO's contention that DOR has only authority to adopt rules and regulations for the apportionment of income incapable of segregation as to source."

The entire question then of the validity of the audit rests upon a determination of whether or not the taxpayer is

conducting a unitary business. If the taxpayer is conducting a unitary business as defined by the regulations adopted by the Department prior to 1974 and by the legislative enactment thereafter, then the taxpayer must file using the unitary method. The taxpayer in its protest claimed that it could separately account and that the Department did not question that it could so separately account. The Department specifically denies the taxpayer can properly separately account. The taxpayer may try to maintain separate books and records, but such is not sufficient under the statute or regulations.

Are then the business activities of the taxpayer within the State of Montana dependent upon the operations of the taxpayer outside the State of Montana? Traditionally there have been two tests utilized for the determination of whether or not a corporation operates a unitary business. The first test is a determination of the existence of the three unities (unity of ownership, unity of operation and unity in a centralized executive force) which was used in the case of *Butler Bros. vs. McColgan*, 315 U.S. 501, (1942) and relied upon by the taxpayer. However, the test embodied by the regulations and statutes involved herein, is the contribution or dependency test as used in *Edison, California vs. McColgan*, 183 P2d 16 (1947). In what ways then are the activities of the cattle operations in Montana dependent upon the general manufacturing operation?

Consider the following facts. Supervision of the cattle operation is conducted by Mr. Lewis Ward, President of Ward Paper Co. who determines the size of herds, oversees cattle purchases, negotiates land purchases and has final approval on all major cattle purchases. Construction of any facilities in the Montana operation require prior approval from the home office. Purchases of any equipment

require prior approval from the home office. Whether or not feed for the cattle will be purchased and how the land is to be utilized rests with final approval of Mr. Ward. All major ranch expenses are approved at the home office. Ranch managers are limited as to the checks which can be written on various ranch accounts; they are given a fixed number of blank checks with which to work. Generally, ranch supplies are ordered and billed directly to the home office. The home office provides payments for all farm vehicle insurance on ranch properties. Capital with which the ranches were purchased was provided by stock dividends in the Russell Stover Candy Company owned by the taxpayer. Operating capital is provided by the taxpayer since the ranch divisions have continued to sustain operating losses. Home office personnel and accountants in Kansas City prepare federal tax returns, financial statements, fuel tax reports, U.C.C. reports, workman's compensation reports and payroll data. Although ranch managers sign the payroll checks, the checks are prepared from the home office. The home office prepares the books and handles payroll for the ranch operations. Each ranch division is allocated an arbitrary overhead charge of $60.00 per month for general and administrative costs, but allocation is not based on hours spent. Insurance for the ranch properties is arranged by the home office through a national agent.

There appears no doubt that the operations of the ranch division are highly dependent on the operations of the home office. Strong centralized management is indicative of a unitary operation. When, as here, there is strong central management in conjunction with the centralization of functions such as financing, accounting, research and purchasing, it is indicative of a single unitary business. It is true that in this case there is no intercompany flow of goods but such a requirement is not absolutely necessary

if the other elements of a unitary business are present. *Superior Oil Co. vs. Franchise Tax Board*, 386 P2d 33, *Honolulu Oil Co. vs. Franchise Tax Board*, 386 P2d 40 (1963). In *Zale - Salem Inc. vs. State Tax Commission*, 391 P2d 601 (1964) the Supreme Court of Oregon found that a unitary business was present when a parent corporation provided the following services for its wholly owned subsidiaries: central buying and manufacturing; central management, accounting, advertising, legal and other services; strict accounting, management control and supervision; paychecks and other disbursements handled by central office; control over personnel including the hiring, training and firing; requirement that the manager of each local corporation submit a daily accounting; all monies received deposited in a local bank and can only be withdrawn by officers of the parent; financial and management interests of the separate corporations conducted by the parent. That case involved a situation dealing with a parent and subsidiary corporations operating in one unitary framework, however, the principals are applicable when separate divisions of a corporation operate within the same framework as is in the present situation.

In addition, the taxpayer provided copies of its state income tax returns filed in the states of Kansas, Missouri and Colorado showing that in those states it is filing on the unitary method claiming the cattle division as a portion of the unitary activities of the corporation, when by the taxpayers own admission, there were no cattle operations conducted in those states.

CONCLUSION

For the reasons herein stated, it is the determination of the Department, after reconsideration, that the assessments proposed in the determination letter of May 30, 1977 are correct.

Respectfully submitted.
JOHN CLARK, Hearing Officer

APPENDIX B

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

STIPULATION FOR STAY, JUDGMENT AND EXECUTION

COME NOW the parties, pursuant to Montana Rules of Civil Procedure and the Montana Rules of Appellate Civil Procedure, and stipulate as follows:

I

That Respondent and Appellant Ward Paper Box Company recovered a judgment in this court in this action which was appealed to the Montana Supreme Court by The Department of Revenue of the State of Montana. That the judgment was reversed by the Order of the Supreme Court in Docket No. 80-375 and remittitur was returned to this court on or about January 25, 1982, following denial of petition for rehearing; and

II

That Respondent and Appellant taxpayer Ward Paper Box Company raised constitutional issues and federal questions related thereto in this proceeding before the State Tax Appeal Board, this court and the Supreme Court

of Montana, and the taxpayer has advised the Department of Revenue it intends to file an appeal and make application for writ of certiorari pursuant to 28 U.S.C. and the Rules of the Supreme Court of the United States and would be entitled to stay entry of judgment herein and to stay the issuance of a writ of execution for the tax liability due pursuant to Fed. R. Civ. P. 50-51 pending lodging of an appeal or application for the writ of certiorari, but Department of Revenue is satisfied ample security is present within the jurisdiction against which the department could enforce its judgment and recover tax and interest due and, therefore;

III

IT IS HEREBY STIPULATED that the entry of judgment on remittitur and issuance of levy of execution pursuant thereto will be considered stayed pending the expiration of time allowed in filing an appeal and making application for writ of certiorari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised in this matter.

DATED this 2 day of February, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Ward Paper Box Company
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

DEPARTMENT OF REVENUE, STATE OF MONTANA

By: Terry B. Cosgrove
Special Assistant Attorney General
P.O. Box 1144
Helena, MT 59624-1144

ORDER

The Court having viewed the foregoing stipulation, the Montana Rules of Civil Procedure and the Rules of Appellate Civil Procedure and, in particular, Rule 7 thereof, and being duly advised in the premises, does hereby;

ORDER that entry of final judgment in this matter and issuance of stay thereon be, and they are hereby stayed pending application for Appeal or Writ of Certiari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised herein [sic].

DATED this 2 day of February, 1982.

PETER MELOY, District Judge

80-375

D.C. No. 44457

IN THE SUPREME COURT OF THE
STATE OF MONTANA
March Term A.D. 1983

Filed: 83 Jul 11

The Chief Justice of the Supreme Court of the State of Montana:

To the Honorable Judge of the District Court of the First Judicial District, in and for the County of Lewis and Clark. Greeting:

WHEREAS, In the said District Court in a cause between Russell Stover Candies, Inc., a Missouri corporation, Respondent and Appellant and Department of Revenue of the State of Montana, Appellant and Respondent wherein the judgment of the said District Court, entered in said cause on the 12th day of August A.D. 1980 was in favor of the said Respondent and Appellant and against the said Appellant and Respondent as by the inspection of the transcript of the record of said Court in said cause which was brought into the Supreme Court of said State by virtue of an appeal, agreeably to the statute of said State and the rules of said Supreme Court in such case made and provided, fully and at large appears.

AND WHEREAS, in the March term of court in the year of our Lord, one thousand nine hundred and eighty-three said cause came on to be heard before said Supreme Court and was argued by counsel.

WHEREUPON, On consideration, it is now here ordered and adjudged by this Court that the Judgment of the Court below, entered in this cause on the 12th day of

August A.D. 1980 is affirmed.

Costs in this Court:
Appellant Appearance - $ no fee
Respondent Appearance - $ 10.00
Remittitur ---------- $ no fee

May 19 A.D. 1983

You, THEREFORE, are hereby commanded that such further proceedings be had in said cause as, according to right and justice, and the laws of the State of Montana ought to be had, not inconsistent with the opinion hereto attached.

WITNESS: The Honorable Frank I. Haswell, Chief Justice of the Supreme Court of the State of Montana, this 7th day of July A.D. 1983

PHYLLIS NEILD
Deputy Clerk of the Supreme Court of the State of Montana

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

RUSSELL STOVER CANDIES, INC., a Missouri corporation,
Respondent and Appellant

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellant and Respondent.

ORDER

Filed: Jul 7, 1983

PER CURIAM:

The petition for rehearing is denied.

DATED this 7th day of July, 1983.

FRANK I. HASWELL, Chief Justice
JOHN CONWAY HARRISON
DANIEL J. SHEA
JOHN C. SHEEHY
FRANK B. MORRISON, JR.
L.C. GULBRANDSON
Justices

APPENDIX C

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

RUSSELL STOVER CANDIES, INC., a Missouri corporation,

Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: Aug. 19, 1983

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, Department of Revenue of the State of Montana, entered in this action on May 19, 1983

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of August, 1983.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan

Attorneys for Respondent and Appellant

301 First National Bank Building

P.O. Box 1715

Helena, MT 59624

CERTIFICATE OF SERVICE

I, Ward A. Shanahan, one of the attorneys for Russell Stover Candies, Inc., the Respondent and Appellant in the above-entitled action, do hereby certify a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage fully prepaid thereon at Helena, Montana, on the 19th day of August, 1983, and directed to the following attorneys:

Mr. Terry B. Cosgrove
Mr. Michael B. Rieley
Montana Club Building
P.O. Box 1144
Helena, MT 59624

WARD A. SHANAHAN

1475D

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

RUSSELL STOVER CANDIES, INC., a Missouri corporation,
Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: Aug 19, 1983

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, Department of Revenue of the State of Montana, entered in this action on May 19, 1983.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of August, 1983.

GOUGH, SHANAHAN, JOHNSON & WATERMAN
Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624

CERTIFICATE OF SERVICE

I, Ward A. Shanahan, one of the attorneys for Russell Stover Candies, Inc., the Respondent and Appellant in the above-entitled action, do hereby certify a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage fully prepaid thereon at Helena, Montana, on the 19th day of August, 1983, and directed to the attorneys listed below; and do further certify that all parties required to be served have been served:

Mr. Terry B. Cosgrove
Mr. Michael B. Rieley
Montana Club Building
P.O. Box 1144
Helena, MT 59624

WARD A. SHANAHAN

1475D

APPENDIX D

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY,

Plaintiff,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Defendant.

MOTION FOR SUBSTITUTION OF PARTIES

COME NOW, Russell Stover Candies, Inc., a Missouri corporation, by and through its counsel, Ward A. Shanahan of the firm of Gough, Shanahan, Johnson & Waterman, pursuant to M. R. Civ. P. 25(c) and moves this Court for an order directing the substitution of Russell Stover Candies, Inc., a Missouri corporation, for Plaintiff, Ward Paper Box Company. This motion is made upon the grounds and for the reasons that Ward Paper Box Company has been merged into Russell Stover Candies, Inc., and the surviving corporation, Russell Stover Candies, Inc., has succeeded to all the interests of Ward Paper Box Company.

Counsel for Defendant, Department of Revenue, has been informed of this motion, has no objection to the granting of the motion and has filed a waiver of hearing of this motion.

Dated this 19th day of March, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

ORDER

Upon Motion of counsel for Plaintiff, Ward Paper Box Company,

IT IS HEREBY ORDERED that Russell Stover Candies, Inc., a Missouri corporation, having succeeded to the interests of Ward Paper Box Company, be substituted as Plaintiff in the above-entitled action, which shall henceforth be styled, "Russell Stover Candies, Inc., a Missouri corporation, Plaintiff, v. Department of Revenue of the State of Montana, Defendant."

Dated this 19th day of March, 1982.

PETER G. MELOY, District Judge

Office - Supreme Court, U.S.
FILED
OCT 31 1983
ALEXANDER L. STEVAS,
CLERK

No. 83-555

In the Supreme Court

of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC., a Missouri corporation, *Appellant*,

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee*.

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

Terry B. Cosgrove
Fourth Floor, Montana Club Building
P.O. Box 1144
Helena, Montana 59624
(406) 442-7450
Counsel for Appellee

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No. 83-555

In the Supreme Court

of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC., a Missouri corporation, *Appellant,*

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee.*

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

Appellee moves the Court to dismiss the appeal herein on the following grounds.

APPELLANT HAS NOT PRESENTED ANY SUBSTANTIAL FEDERAL QUESTIONS WORTHY OF REVIEW BY THIS COURT.

Two questions relating to the proper function of state income tax laws are raised in Appellant's Jurisdictional Statement under the heading "Reasons for Noting Jurisdiction" at page 8. Appellee will demonstrate through its review of these questions that this Court should dismiss this appeal as raising no substantial federal question worthy of review. U.S. Supreme Court Rule 16(1)(b).

A. THE OPERATIONS OF THE APPELLANT CONSTITUTE A UNITARY BUSINESS OPERATION WITHIN CONSTITUTIONAL GUIDELINES.

Appellant's first argument beginning on page 10 of the Jurisdictional Statement in essence is that its corporate operations do not constitute a unitary business. Prior to reviewing the facts as developed in the record of this case, it is important to discuss this Court's most recent pronouncement in the field of state taxation of multistate businesses.

On June 27, 1983, this Court handed down its decision in *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. 4987 (1983). In that case, this Court again discussed the principles of formularly apportionment of income for state taxation of a unitary business. This Court indicated that in reviewing these cases, it will not provide a de novo review on the question of the activities of the taxpayer, but instead will look to see if the state court has applied the appropriate standard. "Rather, our task must be to determine whether the state court applied the correct standards to the case; and if it did, whether its judgment 'was within the realm of permissible judgment' ". 51 U.S.L.W. at 4992.

Standards consistently utilized by this Court in determining the existence of a unitary business arise from the due process and commerce clauses of the constitution. Two requirements are consistently interposed: a minimal connection or nexus between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise. *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). A state must demonstrate that in order to tax an entity as a unitary business, some part of the business activity must take part

in the state, and also that there be some ownership or control uniting the unitary business. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4989.

Additionally, having once found a business to be unitary, a state in applying an apportionment formula must satisfy the due process and commerce clause requirement that the formula is fair and reflects a reasonable sense of how the income is generated.

The scope of review for this case as announced by this Court in *Container* is whether or not the Montana Supreme Court identified the appropriate principles or standards for determining that the Appellant is in fact a unitary business, and if so, whether the apportionment formula is basically fair.

The Supreme Court of the State of Montana has consistently applied the standards set by this Court in determining the existence of a unitary business. Citing from both *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980) and *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940), the Montana Supreme Court in its original decision in the present matter, made specific reference to the requirements set forth by the Constitution. See appendix to Jurisdictional Statement p. 19. Assuming the Montana court has applied the appropriate standard, the question becomes whether the decision of the Montana Supreme Court is within the realm of permissible judgment. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4992.

In reviewing the facts, it becomes manifestly clear that this corporation operated as a unitary business. Appellant's argument that the box divisions and the ranch divisions are functionally distinct and separate in both a business and economic sense simply is not based on fact. Appellant argues that this Court will not allow the finding

of a unitary business unless vertical integration exists in a taxpayer's activities. This has been specifically refuted by this Court in *Container*. Appellant in its jurisdictional statement has very carefully failed to mention the statutory or standard applied in Montana for the determination of a unitary business. The Montana statutory definition of a unitary business is contained in Section 15-31-301(2), MCA, and provides as follows:

> (2) A corporation engaged in a unitary business within and without Montana must apportion its income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.

This definition is applicable throughout the entire period of the audit. *Montana Department of Revenue v. American Smelting & Refining Company*, 173 Mont. 316, 567 P.2d 901 (1977), *appeal dismissed* 434 U.S. 1042 (1978).

The Wisconsin Supreme Court, in the *Exxon* case, utilized this same test: "The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary." *Wisconsin Department of Revenue v. Exxon Corporation*, 90 Wis. 2nd 700, 281 N.W.2d 94, 100 (1979). A test which this Court has approved.

It is true that the previous cases before this Court regarding the question of the existance of a unitary business, have been factual situations involving either manufacturing corporations, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); general merchandising businesses, *Butler Brothers v. McColgan*, 315 U.S. 501

(1942); multistate distributors, *Bass, Ratcliff and Gretton v. State Tax Commission*, 266 U.S. 271 (1924); or integrated oil companies, *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). This factual situation in the present case is therefore somewhat unique in that it involves the activities of a company operating in more than one type of business. However, this Court has never held that vertical integration is a prerequisite for a finding of a unitary business. In fact, this exact argument was presented to the Court in the *Container* case, i.e. that a flow of goods was a prerequisite to a unitary business. Hopefully for the last time this Court made it quite clear that such a requirement is not necessary.

> The prerequisite to a constitutionally acceptable finding of unitary business is a flow of value, not a flow of goods . . . . "[S]ubstantial mutual interdependence," (citation omitted) can arise in any number of ways; a substantial flow of goods is clearly one but just as clearly not the only one.

Container Corporation v. Franchise Tax Board, 51 U.S.L.W. at 4992.

The facts of the instant case demonstrate substantial mutual interdependence arising from the activities of the taxpayer. General management decisions for all divisions were made at the home office. All funds generated by any division were co-mingled and utilized for any needs of the corporation. The ranch divisions were staffed so that they simply could not operate without the services provided by the home office. Appendix to Jurisdictional Statement, pp. 4 and 5. Clearly, these operations cannot be considered "discreet business enterprises", as Appellant suggests, since they are managed, controlled, and funded in the identical manner as all other divisions of the corporation. Contribution or interdependence is ascertained and established from determining such factors as the level

at which major policy matters are established, or the types of services, including financing, accounting, legal, insurance, purchasing, or other services which are provided to the local operations by the home office. *W.R. Grace & Company v. Commissioner of Revenue*, 378 Mass. 577, 393 N.E.2d 330 (1979); *Superior Oil Company v. Franchise Tax Board*, 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963); *Honolulu Oil Company v. Franchise Tax Board*, 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963); *Department of Taxation v. Lucky Stores, Inc.*, 217 Va. 121, 225 S.E.2d 870 (1976); *Montana Department of Revenue v. American Smelting and Refining Company*, 173 Mont. 316, 567 P.2d 901, *appeal dismissed*, 434 US.. 1042; and *Chase Brass and Copper Co., Inc. v. Franchise Tax Board*, 10 Cal. App. 3d 496, 86 Cal. Rptr. 350 (1970), *appeal dismissed*, 400 U.S. 961 (1970).

When a local in-state division cannot operate without relying on the out-of-state home office for anything other than the most routine day-to-day decisions; centralized services, including such simple things as balancing of checkbooks, making bank deposits, paying bills; or the influx of capital generated by other divisions of the corporation to meet its basic needs, it is inconceivable to assert that the local operation is not dependent upon the operations of the business conducted in other states. When a division is so intertwined with the general overall operations of the company, as in the situation now before this Court, notwithstanding that it produces a different product, it cannot be said that it constitutes an unrelated business activity.

In addition, the ranch divisions operated in the same basic fashion as the box divisions whether it be from cash needs, the handling of funds, or the general management of either the box or cattle divisions. (Transcript, volume 1, p. 163, 165, 166). Other than the fact that the divisions

produced different products, the box divisions were as autonomous from each other as they were from the ranch divisions.

It was noted at the trial of this matter that the box divisions had the same operational supervision as the ranches. There was no joint advertising program, no common salesman, no common guarantees among themselves, the box divisions did not purchase materials jointly, did not purchase expendables commonly for the divisions. (Transcript, volume 1, p. 171, 173, 174). Yet the Appellant has always maintained that the box divisions themselves were unitary. Because of the diversity of the products, this company is not highly integrated. However, it also is not a corporation simply making a totally unrelated business investment in Montana. It is not the situation of a manufacturing concern which would have a separate division purchasing all materials, a separate division handling production, a separate division handling sales. There isn't the instance of the purchasing of materials on a volume basis for all the box divisions but not the ranches. There isn't the transferring of employees throughout the box divisions but not the ranches. What is present is a chairman of the board who runs the total company as he sees fit, whether it be in the box or cattle business. The factors which establish that the box divisions are a unitary business are the same factors as for the ranches. Other than the fact that the cattle divisions produce a different type of product, the operation between the various divisions and the home office is basically the same.

All finances whether for a box or ranch division were handled identically. The theme running throughout the handling of the funds by the corporation was to treat all the divisions as one economic unit, all generating income for all company needs, and the president of the company

making determinations on disbursements of funds for the general economic benefit of the company as a whole. It is not as the Appellant would argue, a situation where the ranches wre completely autonomous. A situation where they would buy and sell cattle and then directly account for any and all funds they have expended or generated. Funds these divisions generated were utilized in the overall company operation, and funds they needed for expenses came from the overall company operations.

Such can also be seen from the treatment afforded by Appellant of the Montana operations in the other states in which it was required to file state income tax returns. As the Court is aware under the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) a corporation is only required to apportion its "business income" to the various states in which it conducts a unitary business. Income arising from activities and transactions occurring outside the business operation of the taxpayer is allocated on the basis of either the taxpayer's commercial domicile in the case of dividends, or to the business situs of the taxpayer in the case of capital gains and sales of real property. Section 15-31-304, MCA, contains the same language as the California statute in *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4989, n. 1. Consistent therewith Appellant treated all interest income as "nonbusiness income" because in the opinion of the accountant for the Appellant, the corporation was not in the business of earning interest income but was in the paper box business. Therefore his opinion was that such income was not generated from transactions or activities in the regular course of the taxpayer's trade or business and should be allocated solely to its state of commercial domicile.

However, such treatment was not afforded to the Montana divisions as noted in the Montana Supreme Court Opinion appendix to Jurisdictional Statement p. 3. The

Appellant filed its tax returns in every other state in which it was operating under the unitary apportionment method including therein the operations of the ranch divisions. In one instance the Appellant indicated the investment income was not apportionable because it was not part of the taxpayer's trade or business. If, as Appellant argues, the Montana divisions constituted an "unrelated business investment" and were not part of its regular trade or business, then income arising from the Montana operations should have been treated as "nonbusiness income". However, Appellant's tax treatment of the ranch divisions is not consistent with that position. In fact, Appellant included the ranch divisions as part of its regular trade or business in every state in which it operated except Montana. The auditor for Appellant upon questioning, admitted that the reason for such treatment of the ranch operations was because they in fact constituted a portion of Appellant's trade or business operation. Transcript, volume 2, p. 48, line 2 to p. 49, line 21.

Nothing in the decisions of this Court in *ASARCO, Incorporated v. Idaho State Tax Commission*, 458 U.S. 307, 73 L. Ed. 2d 787 (1982) or *F.W. Woolworth Company v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 73 L. Ed. 2d 819 (1982) contradict in any way the determination of the Montana Supreme Court. The facts of those cases clearly are distinguishable from the present case. Beginning with *Woolworth*, this Court found that there was no integration between Woolworth and its subsidiaries since the subsidiaries operated autonomously and independently. The subsidiaries had their own separate and complete accounting department and financial staff; did not engage in centralized purchasing, manufacturing, or warehousing for the subsidiaries; had no centralized personnel training for subsidiary personnel; and each subsidiary was responsible for obtaining its own

financing from sources other than the parent. *F.W. Woolworth Company v. Taxation and Revenue Department of New Mexico*, 73 L. Ed. 2d at 828-29. The subsidiaries developed their own sales programs, managerial staff, and instructed their staff in their own methods of operation. They developed their own policies with regard to retailing, they were responsible for determining the size and location of their stores, market conditions, and items to be sold. The parent did not review the tax returns or consult with them on decisions affecting taxes. Woolworth had no policy requiring that subsidiary managers carry out meetings. The most that could be said was that Woolworth had irregular and infrequent contact and then only for occasional oversight. Likewise in *ASARCO*, this Court found that because the subsidiaries were not realistically subject to even minimal control by the parent, they were passive investments, in the basic sense of that term, and could not be included as a portion of the unitary business.

The facts of *Woolworth* and *ASARCO* are distinguishable from the present case and in no way contravene this Court's opinions in those matters. The facts of the present case are more akin to the recent *Container* decision. In *Container* there was a substantial role played by the parent in loaning funds to the subsidiaries and guaranteeing loans provided by others. There was substantial technical assistance provided and supervisory role played by the officers in general guidenace, *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4991. In addition day-to-day management decisions of the subsidiaries were left in the hands of local executives and decisions regarding capital expenditures were subject to review, the overall management of the company was controlled by the parent. *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4991.

The facts in the present case clearly are distinguishable from the *ASARCO* and *Woolworth* cases, and are consistent with the *Container* decision. The operations of the Appellant within Montana did not constitute an unrelated business investment, but were in fact an expansion of its business. From accounting, managerial, and financial standpoints all divisions, whether box or cattle operated essentially in the same way. The Montana operations were incorporated as a part of the totality of the Appellant's method of operation. This type of assimilation was discussed in *Container*.

> The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy. In this case, the business "guidelines" established by appellant for its subsidiaries, the "consensus" process by which appellant's management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by appellant, all point to precisely the sort of operational role we found lacking in *F.W. Woolworth*.

Container Corporation of America v. Franchise Tax Board, 51 U.S.L.W. at 4993, n. 19.

The Montana Supreme Court in reviewing the facts concerning how Appellant operated, found specifically that it met the approved unitariness definition. A corporation which benefits from an umbrella of centralized management and controlled interaction, constitutes a unitary business.

B. HAS THE USE OF THE THREE FACTOR FORMULA VIOLATED CONSTITUTIONAL GUIDELINES FOR APPORTIONMENT OF INCOME.

Issue B raised by Appellant argues that the use of the three factor formula has produced an apportionment of income which is "out of all appropriate proportion to the

business transacted by Appellant in Montana." Jurisdictional Statement p. 19. This Court in *Container* reiterated that it is constitutionally permissible to require a unitary business, to use formulary apportionment, as long as the formula has both internal and external consistency. In other words, the formula must be such that if applied by every jurisdiction no more than all of the unitary businesses income would be taxed; and must actually reflect a reasonable sense of how income is generated. *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4990. The formula utilized by Montana meets both of those standards.

As has been noted by this court numerous times, an apportionment formula cannot be expected to be exact due to the inherent problems a state has in attempting to place upon a business extending into several states "its fair share of the burden of taxation", especially when faced with the impossibility of allocating specifically profits earned within its borders. *Butler Brothers v. McColgan*, 315 U.S. at 507. Such simply is the inherent problem with a unitary operation.

Montana and the other states that have adopted the uniform act utilize the "three factor formula". The formula attempts to view the overall operations of a corporation by giving weight to the factors of payroll, property, and sales. This formula has been approved specifically by this Court.

> We approved the three-factor formula in *Butler Brothers v. McColgan, supra*. Indeed, not only has the three-factor formula met our approval, but it has become, for reasons we discuss in more detail *infra* at 21-22, something of a benchmark against which other apportionment formulas are judged.

Container Corporation of America v. Franchise Tax Board, 51 U.S.L.W. at 4990.

In *General Motors Corp. v. District of Columbia*, 380 U.S. 553 (1965) although not decided on constitutional grounds, this Court specifically discussed the prevalence of the three factor formula by the majority of states requiring payment of such tax, and concluded that the utilization of such a formula tends to eliminate the possibility of multiple taxation of corporate net income by states using formulas based on one or two factors. "The standard three factor formula can be justified as a rough, practical approximation that the distribution of either a corporation's sources of income or the social cost which it generates." *Id* at 561.

When applying the three factor formula to the internal and external consistency requirements mentioned by this Court in *Container*, it is obvious that it meets both standards. As to internal consistency, nothing could be more fair than to have this formula applied by every jurisdiction in which the taxpayer was operating. Obviously no more than all of the unitary business income would be taxed if this were true. As to the external consistency, the use of the formula does reasonably reflect a sense of how the income was generated. Appellant has argued that because the sales of the Montana divisions constituted between 1% and 7% of the total sales and the payroll was between 3.2% and 15.5% of the total payroll this is a distortion in relation to the overall income. What the Appellant has failed to mention is that property, the third factor of the formula must also be included in the formularly apportionment, and over 60% of the real property owned by the corporation is located within Montana.

Appellant would like to equate solely the value of the Montana divisions in relation to the sales they generate. Appellant is in effect saying that the property of the corporation has no functional value in the overall unitary operation and should be given no weight in the apportion-

ment formula. This is in spite of the fact that in other states the Appellant files its return on the unitary basis and includes therein the Montana operations as part of the apportionment formula. Appellant argues that the tax attributable to Montana is all out of proportion to its activities in Montana, yet Appellant includes in its apportionment factors for every other state all of the payroll, sales and yes, property of the Montana activities.

Appellant has cited extensively from the case *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931) wherein this Court struck down a single factor formula on the grounds that the average income having its source within North Carolina was 17%, while under the assessment method was allocated 80% of the income. Based on that record and the fact it was a single factor formula this Court found that the operation of the tax was unreasonable and arbitrary. Clearly the same argument cannot be utilized in the present case. Here, the use of the formula acknowledges that more goes into the generation of income, and the proper apportionment of income then merely looking only at a single factor, i.e., sales. By giving equal weight to all factors, the formula takes into account the overall presence of a corporation within a taxing state. The action of the Montana Supreme Corut is consistent with this Court's previous holding in *Butler Brothers v. McColgan*, 315 U.S. at 509.

> We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors may properly be deemed to reflect "the relative contribution of the activities in the various states to the production of the total unitary income", so as to allocate to California its just proportion of the profits earned by Appellant from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula.

Appellant is a unitary business. The Montana apportionment factors include payroll, property, and sales which are a part of this unitary operation. The taxpayer has "the distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed." *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4991. The use of the three factor formula for a unitary business results only in the proper apportionment of income. Appellant has therefore raised no argument which invalidates this tax under the due process clause or commerce clause of the fourteenth amendment of the United States Constitution.

CONCLUSION

Appellant's issues have been dealt with previously by this Court, the action of the Supreme Court of Montana is fully consistent with this Court's decisions, therefore no substantial federal question has been raised and Appellee's Motion to Dismiss should be granted.

Respectfully submitted,

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No. 83-555

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

BRIEF IN OPPOSITION TO MOTION TO DISMISS APPEAL

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Appellee.

On Appeal from the Supreme Court of Montana

BRIEF IN OPPOSITION TO MOTION TO DISMISS APPEAL

The Appellant submits the following brief in opposition to the Appellee's Motion to Dismiss Appeal.

SUBSTANTIAL FEDERAL QUESTIONS ARE RAISED

The Appellee's Motion does not rebut the Appellant's position that substantial federal questions requiring plenary consideration by this Court are raised in this case. Indeed, in recognizing that the facts of this case are unlike those involved in any prior decisions of this Court, Appellee has admitted that its position represents a significant extension of the unitary business principle. In addition, the Department has not supported its position that the income allocated to Montana by application of the

three-factor formula is related to the intrastate values of the Appellant's activities. As such, the position of the Appellee raises substantial federal questions which should be fully addressed by this Court.

A. *The Department's Application of the Unitary Business Principle to the Appellant's Operations is Constitutionally Impermissible.*

The Appellee's application of the unitary business principle to the Appellant's business operations is an attempt to extend the taxing power of the State of Montana beyond its borders and to expand the unitary business principle. Appellee recognizes that this case presents a factual situation that is "somewhat unique in that it involves the activities of a company operating in more than one type of business." Appellee's Motion to Dismiss Appeal (hereinafter Motion), p. 5. The unitary business principle has never been sanctioned for use where a business organization engages in two distinct business activities which are functionally separate and connected only by common ownership, minimal administrative ties and a resulting flow of funds.

In all recent cases involving the unitary business principle, this Court has addressed situations where the taxpayer's operations within the taxing state were substantially identical to, or part of an integrated operation with, its activities outside the taxing state. Here, the Taxpayer's business operations within the taxing state are totally distinct and separate from its operations outside the state. There is no operational link, other than that provided by common ownership, minimal administrative ties and a flow of funds, between the Taxpayer's in-state and out-of-state activities. The application of the unitary business principle to this Taxpayer's operations represents an extension of the unitary business principle and raises a

substantial federal question meriting this Court's further consideration.

The federal issue raised here is especially significant as the factors relied upon by the Department to justify its application of the unitary business principle have been previously addressed by this Court and found insufficient to constitute a unitary business. In *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 787 (1982), and *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 819 (1982), this Court dealt with all of the factors relied upon by the Department here to justify its position. In so doing, the Court found that control of major management or financial decisions did not evidence a unitary business. *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 73 L. Ed. 2d at 831; *ASARCO, Inc. v. Idaho State Tax Commission*, 73 L. Ed. 2d 801, n. 22.

Further, the provision of centralized services by a parent to a subsidiary was found insufficient to link what otherwise would be distinct business operations. *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 73 L. Ed. 2d at 831, n. 22. Finally, reliance upon a transfer of funds between the subsidiary and the parent to justify unitization was held to be a subversion of the unitary business principle. *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 73 L. Ed. 2d at 827, n. 11. The factors relied upon by the Department here have been addressed by this Court. The statements of this Court regarding these factors have been ignored by both the Department and, more importantly, by the Montana Supreme Court in its decision following remand.

In view of the fact that the Montana Supreme Court, in its decision following remand, ignored the opinions of this Court in *ASARCO* and *Woolworth*, it is apparent that the Montana court has not applied the correct standards to the facts of this case. While the Montana court correctly set forth general principles concerning the unitary business principle, it did not apply the guidelines of this Court contained in *ASARCO* and *Woolworth*. Further, in light of the "unique" facts of this case, the decision of the Montana court, holding that the Appellant's business operations constitute a unitary business, falls outside of the realm of permissible judgment and violates the due process guarantees of the Fourteenth Amendment to the United States Constitution.

The Department argues that the operation of the box divisions, *inter se*, and the manner in which the Appellant reports its income in other states, are of great significance for this case. Motion, pp. 6-9. However, the issue involved here is the taxing authority of the State of Montana. Due process analysis focuses upon the business activities of the taxpayer within the taxing state and their connection with the activities of the taxpayer outside the taxing state. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. 425, 442 (1980); *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 223 (1980). The relationship of the Taxpayer's various out-of-state activities to one another cannot affect the constitutional limitations upon the taxing authority of the State of Montana. The manner in which the Taxpayer reports its income in other states is similarly irrelevant.

In discussing the operations of the Taxpayer's box divisions, the Department argues that the box divisions had no joint advertising program, no common salesmen, no common guarantees, and did not purchase materials jointly.

Motion, p. 7. What is not stated is that there was no advertising program at all for any of the box divisions and no salesmen for any of the divisions. Transcript, Vol. 1, pp. 171-172. Further, the Department states that "the box divisions did not purchase materials jointly" and cites Transcript, Vol. 1, pp. 171-174. Motion, p. 7. The Transcript, to the contrary, reveals that four of the box divisions had a common purchasing agent. On the other hand, the ranches made their own purchases. Transcript, Vol. 1, pp. 106, 174.

More importantly, Appellee failed to mention that all of the box divisions had a common interchange of equipment and technical services. Transcript, Vol. 1, pp. 172-173. (Transcript pp. 171-174 have been attached as Appendix E.) This was not the practice with the Montana ranch divisions. Transcript, Vol. 1, pp. 106, 109. Most significantly, the paper box divisions all produced paper boxes and related materials. Thus, if relevant, the box divisions are plainly unitary among themselves. That conclusion does not mandate a determination that the ranch divisions are unitary with the box divisions or even affect the question. The connections which exist between the ranch divisions and the box divisions are the significant issue. Those connections are insufficient to justify a conclusion that the ranch divisions are part of a unitary business which includes the box divisions.

Moreover, the manner and method in which the Appellant files its tax returns in other states cannot confer constitutional propriety upon the position taken by the Montana Department of Revenue in this case. As this Court has stated, the constitutionality of a state tax does not depend upon the vagaries of another state's tax policy. ***Mobil Oil Corporation v. Commissioner of Taxes***, 445 U.S. at 444; ***Exxon Corporation v. Wisconsin Department***

of Revenue, 447 U.S. at 228-229. The actions of other states in applying the unitary business principle or of the Appellant in filing in other states as a unitary business cannot convert an otherwise unconstitutional extension of a state's taxing power into a constitutionally permissible exercise of that power.

The Department has argued that the facts of this case are clearly distinguishable from the facts presented in *ASARCO* and *Woolworth* and are more consistent with the facts contained in *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. 4987 (1983). Each of those cases is factually distinct from this case. All of them involved business operations in the taxing state which were substantially similar to or integrated with business operations outside the taxing state. *Woolworth* involved foreign subsidiaries engaged in the same retail sales business conducted by the parent in this country. *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 73 L. Ed. 2d at 828. *ASARCO* involved subsidiaries which were engaged in mining, milling, smelting and refining of nonferrous metals or in the fabrication and manufacture of metal products. *ASARCO, Inc. v. Idaho State Tax Commission*, 73 L. Ed. 2d at 791, n. 2. *Container* involved a vertically-integrated parent corporation engaged in manufacturing custom-ordered paperboard packaging. Its foreign subsidiaries were all engaged in their local markets in essentially the same business. *Container Corporation of America v. Franchise Tax Board*, 51 U.S.L.W. at 4990. Further, except for the provision of operating funds, none of the factors relied on by the court in *Container* is present in this case. Here, the corporate home office does not provide assistance to the ranching operations in equipment interchange or purchases or in filling personnel needs. Further, the home office does not provide technical

assistance to or play a supervisory role in day-to-day operations of the Montana ranching operations. Therefore, this case is substantially different from all three cases. The Taxpayer's ranching operations are totally dissimilar from its paper box production activities. Its ranching operations are not vertically integrated at any functional level with the operations of the paper box divisions.

The Appellant's ranching operations are discrete business enterprises. Indeed, if those operations are not discrete enterprises, then nothing is likely to qualify for the designation. The ranching operations are separated from the paper box operations in every meaningful sense. They are joined only by common ownership and the connections which arise therefrom. The provision of administrative services, the control of major management decisions, and a flow of funds between the home office and the ranching divisions are not sufficient to convert the ranching operations into aspects of a unitary business. Decisions to the contrary, left unchallenged, remove all effective limitation upon the unitary business principle. In such an instance, a "discrete business enterprise" would be possible only through complete organizational separation, leaving only stock ownership as a possible connector.

For these reasons the issue of the applicability of the unitary business principle to the Taxpayer's operations located within and outside the State of Montana presents a substantial federal question which merits plenary consideration by this Court.

B. *Income Allocated to Montana by Use of the Three-factor Formula is not Rationally Related to the Intrastate Values of the Taxpayer's Enterprise.*

The Appellant maintains that the three-factor formula applied by the State of Montana to its operations, located

both within and outside the State of Montana, has produced an allocation of income to the State of Montana which is out of all appropriate proportion to the business transacted by the Appellant in Montana. The formula applied by the Department of Revenue has allocated to Montana between 19% and 30% of the total net income of the corporation in each of the tax years involved. This allocation has been made despite the fact that, in each of the years involved, the Montana ranching operations had no net income and in fact sustained substantial losses. During the same period, the sales of the products of the Montana operations were 1% to 7% of the total sales of the corporation, and the Montana payroll was 3% to 15% of the total corporation payroll.

This distortion is caused by the third factor of the formula — the property factor. The Montana ranch lands, livestock and equipment constitute a substantial portion of the Taxpayer's total property. The effect of the three-factor formula, given this fact, is to convert the tax from an income-based tax to a property tax at a time when the Taxpayer already pays taxes upon its real and personal property located in Montana.

The tax involved here is meant to be an income tax, to measure the amount of income earned in Montana. While the property factor no doubt contributes to the earnings of income from the Montana ranching operations, it is readily apparent that the ranching operations did not in fact generate income at all, much less 19% to 30% of the corporation's total net income.

The Department argues, in effect, that because this Court has approved the three-factor formula in principle, its application to concrete circumstances cannot produce a distorted allocation. Such analysis would eliminate the requirement of a rational relationship between the income

apportioned to a taxing state and the intrastate values of the enterprise. Such was the position of the Montana Supreme Court in its initial decision where it stated:

> The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate values of the corporation.

Appendix to the Jurisdictional Statement, p. 19.

While this Court has approved the three-factor formula in principle and recognized its utility in apportioning taxes, it has also noted that apportionment formulas can lead to distorted results. Accordingly, this Court has held that, when a Taxpayer produces evidence that the formula yields "a grossly distorted result in its particular case, the State is obliged to counter that evidence and to make accommodations necessary to assure that its taxing power is confined to its constitutional limits." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. 317, 329 (1968).

Here, the allocation produced by use of the formula converts substantial losses in each of the tax years into significant amounts of net income, and it increases the tax due from the Appellant by between 521 and 896 times. Thus, the formula employed by the Appellee increases taxable income attributable to Montana and the tax to be paid by the Appellant in percentages which far exceed the percentage increases which led this Court to strike down state taxes in *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931) and *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. 317 (1968).

The decision of the Montana Supreme Court, if left intact, will sanction the elimination of the requirement of a rational relationship between income allocated to a state and the intrastate values of the enterprise. The position of the State of Montana in applying the three-factor formula in the face of the substantial distortion involved here raises a substantial federal question which requires plenary consideration by this Court for its resolution.

CONCLUSION

The Motion to Dismiss Appeal submitted by the Department of Revenue does not rebut the Appellant's position that substantial federal questions are raised. In view of the facts of this case, the position of the Department of Revenue, and the decisions of the Montana Supreme Court, this case raises substantial federal questions which merit plenary consideration by this Court.

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November, 1983

Pages misnumbered in original copy.

APPENDIX E

(Explanatory Note: The Witness is Mr. Jerome Keating, Controller of Ward Paper Box Co., the Taxpayer's predecessor in interest. The questioner is Mr. Ward A. Shanahan, Counsel for Taxpayer.)

(p. 171)

Box Company when these items were advanced to the ranch divisions?

A. No, sir.

Q. At any time?

A. At no time.

Q. Has the Department ever advised you that anything other than the three-factor formula was available for the computation of the tax in Montana under the unitary method?

A. They have not advised me.

Q. Between the box divisions, these divisions also have, as you testified — I think you said the same operational supervision, generally. The managers report to Mr. Bowers and Mr. Ward, is that right?

A. Yes, sir. The box divisions mostly to Mr. Bowers?

Q. And he spends most of his time on the box division business?

A. Yes, sir.

Q. How about public advertising, do the box divisions have joint advertising programs?

A. We have no advertising.

Q. Do they have any salesmen?

A. We do not have salesmen.

Q. Do they make common guaranties to customers?

(p. 172)

A. Do they make — no, sir.

Q. There are two that work different payroll records and tax reports, that's Smiley and Quincy?

A. Yes. They have their own accounting functions.

Q. They do all their own accounting altogether?

A. Yes, sir.

Q. And they're essentially autonomous?

A. Yes, sir, with the exception at Smiley we pay their bills. Quincy pays their own.

Q. Do personnel from various divisions of the box divisions move from one division to another?

A. No, sir.

Q. How about the managing staff?

A. No, sir.

Q. They've never moved from one to the other at all?

A. No, sir.

Q. Why was the Denver Division terminated?

A. It was not a profitable organization.

Q. They do exchange equipment, however?

A. Yes, sir.

Q. If there's a piece of equipment at one division that could be used at another, then it's moved over there and used?

A. Yes, sir. Mr. Ortega will buy equipment, overhaul it, repair it, and assign it to whichever division is

(p. 173)

necessary.

Q. Mr. Ortega is the general maintenance and engineering supervisor for the whole box division set up?

A. Yes, sir.

Q. Are there any other employees such as Mr. Ortega who do things for more than one box division?

A. No, sir.

Q. How about trucking facilities?

A. No common trucking facilities.

Q. They all have their own personal trucks for each division?

A. The smaller divisions do not have trucks.

Q. There are certain divisions that produce slightly different types of boxes than others?

A. Yes, sir.

Q. Would you explain what those are?

A. Smiley Container Division produces what's considered the heart-shaped boxes, specifically for Valentine's Day and some sales other periods of time.

Q. With respect to the heart-shaped boxes that are produced, what share of the market does that division have of all of the heart-shaped boxes in the United States?

A. Eighty to 90 percent.

Q. So it produces heart-shaped boxes for more than one candy company?

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A. Yes, sir. Brachs, McDonalds.

Q. As a matter of fact, there are some divisions that produce one size of heart-shaped box and another one produces another?

A. Yes, sir. Quincy Paper Box also produces heart-shaped boxes.

Q. Are there people who procure paper that is used commonly by all of the divisions?

A. By all of the divisions?

Q. Yes.

A. Smiley purchases their own. Quincy purchases their own. Ward Paper Box purchases for Ward, Clarksville, Marion, Montrose.

Q. Who makes those purchases?

A. James Dores (phonetical).

Q. Luehrs?

A. Luehrs.

Q. So he's a person who does a common job in purchasing materials and supplies for those divisions?

A. Yes, sir.

Q. How about such things as expendables, toilet paper, soap, cleaning compounds, that sort of thing?

A. That's purchased by the divisions.

Q. At the particular area?

A. Yes, sir.